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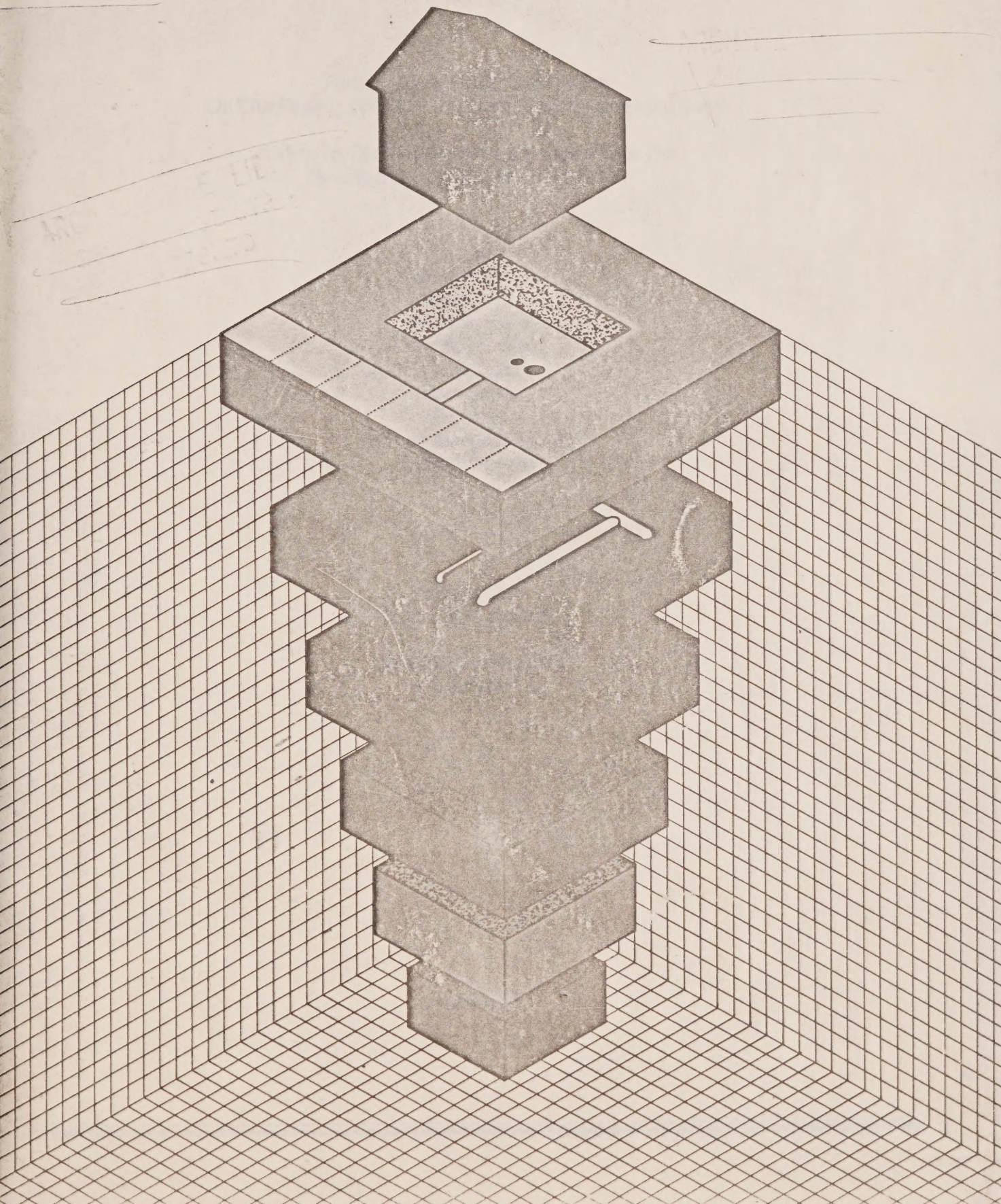
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Down To Earth

Volume One

Government
Publication

The Report Of The Federal/Provincial Task Force
On The Supply And Price Of Serviced Residential Land



Federal/Provincial Task Force
On The Supply And Price Of Serviced Residential Land

A Report For The Ministers Responsible For
Housing Of The Governments Of:

Canada
British Columbia
Manitoba
Newfoundland
New Brunswick
North West Territories
Nova Scotia
Ontario
Prince Edward Island
Saskatchewan

Volume One
Chairman's Report

David B. Greenspan
Chairman

April 1978

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The views expressed in this Report are those of the Chairman and do not necessarily reflect those of sponsoring governments, contributors or other participants.

Table of Contents

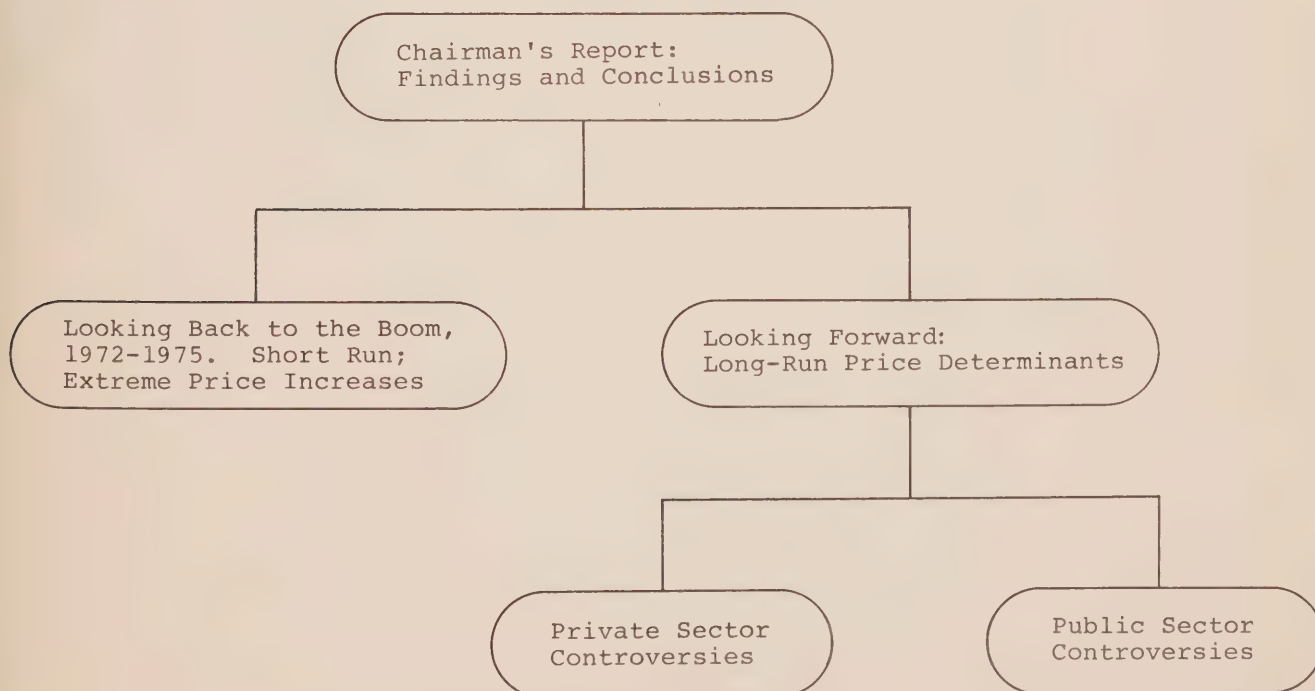
This Report consists of three volumes. Volumes One and Two are being published at this time. Volume One is the Chairman's Report. Volume Two is the technical report containing a synthesis and summary of the background research. A future Volume Three, entitled Research Studies Volume, will contain the full texts and data sets of research studies and the standardized research methodologies the Task Force has developed for profitability of individual subdivisions, servicing standards and costs, concentration of land ownership, infill rezoning and citizen resistance to development.

INDEX TO FINDINGS	<i>i</i>
INDEX TO FIGURES AND TABLES	<i>iii</i>
1. INTRODUCTION	2
1.1 Why The Task Force Was Created	2
1.2 Our Three Basic Purposes	2
1.3 How We Tackled Our Task	3
2. THE REAL ESTATE BOOM OF 1972-1975 WITH HINDSIGHT	5
2.1 How Real Was The Real Estate Boom?	5
2.2 Popular "Conspiracy" Theories	5
2.3 Looking For Answers	13
2.4 The Surge In Housing Demand	20
2.5 Asset Revaluation - The Real Reason Behind The Boom	20
3. AFTER THE BOOM	31
4. LONG-RUN PRICE DETERMINANTS: PUBLIC SECTOR CONTROVERSIES	33
4.1 Planning, Approvals And Municipal Taxes	33
4.1.1 Planning Versus Production	33
4.1.2 Length Versus Restrictiveness	38
4.1.3 Taxes Versus Homes	39
4.1.4 Planning Versus Economic Reality	43
4.2 Servicing, Lot Levies And Federal Taxes	44
4.2.1 The Relationship Between Servicing Costs And Lot Prices	44
4.2.2 The Relationship Between Municipal Servicing Standards And Servicing Costs	45
4.2.3 The Financial Burden Of Land Development	49
4.3 Citizen Resistance To New Residential Development	50
4.4 Government Land Banking And Servicing	52

Table of Contents

5.	LONG-RUN PRICE DETERMINANTS: PRIVATE SECTOR CONTROVERSIES	62
5.1	High Prices And High Profits, Which Caused Which?	62
5.2	Is The Development Industry Concentrated Now?	67
5.3	Might The Development Industry Become More Concentrated In The Future?	72
6.	CONCLUSIONS	75
6.1	The Short Run Boom, 1972-1975 - Asset Revaluation Was The Real Cause, Not Monopolistic Developers Or Government Red-Tape	75
6.2	The Law Of Supply And Demand: Not Yet Repealed	76
6.3	Long-Run Prices: Government Is The Key	77
6.4	Not The Last Word	78
7.	OUR FINDINGS COLLECTED IN ONE PLACE	79
APPENDIX 1.	CRITICAL REVIEW: HOW IT WORKED	89
APPENDIX 2.	TERMS OF REFERENCE	92

REPORT STRUCTURE



Index to Findings

2.	THE REAL ESTATE BOOM OF 1972-1975	
2.2	Popular "Conspiracy" Theories	
	Finding 1	5
	Finding 2	6
2.3	Looking For Answers	
	Finding 3	13
	Finding 4	19
2.5	Asset Revaluation - The Real Reason Behind The Boom	
	Finding 5	21
3.	AFTER THE BOOM	
	Finding 6	32
4.	LONG-RUN PRICE DETERMINANTS: PUBLIC SECTOR CONTROVERSIES	
4.1	Planning, Approvals And Municipal Taxes	
	Finding 7	34
	Finding 8	35
	Finding 9	39
	Finding 10	43
	Finding 11	44
4.2	Servicing, Lot Levies And Federal Taxes	
	Finding 12	45
	Finding 13	47
	Finding 14	47
	Finding 15	49
	Finding 16	49
4.3	Citizen Resistance To New Residential Development	
	Finding 17	52
4.4	Government Land Banking And Servicing	
	Finding 18	55
	Finding 19	55
	Finding 20	57
	Finding 21	58
5.	LONG-RUN PRICE DETERMINANTS: PRIVATE SECTOR CONTROVERSIES	
5.1	High Prices And High Profits, Which Caused Which?	
	Finding 22	63
	Finding 12 Revisited	64
	Finding 23	64
	Finding 24	64
	Finding 25	66
	Finding 26	66
	Finding 27	67

Index to Findings

5.2	Is The Development Industry Concentrated Now? Finding 28	72
5.3	Might The Development Industry Become More Concentrated In The Future? Finding 29	73
6.	CONCLUSIONS	
6.3	Long-Run Prices: Government Is The Key Finding 30	77

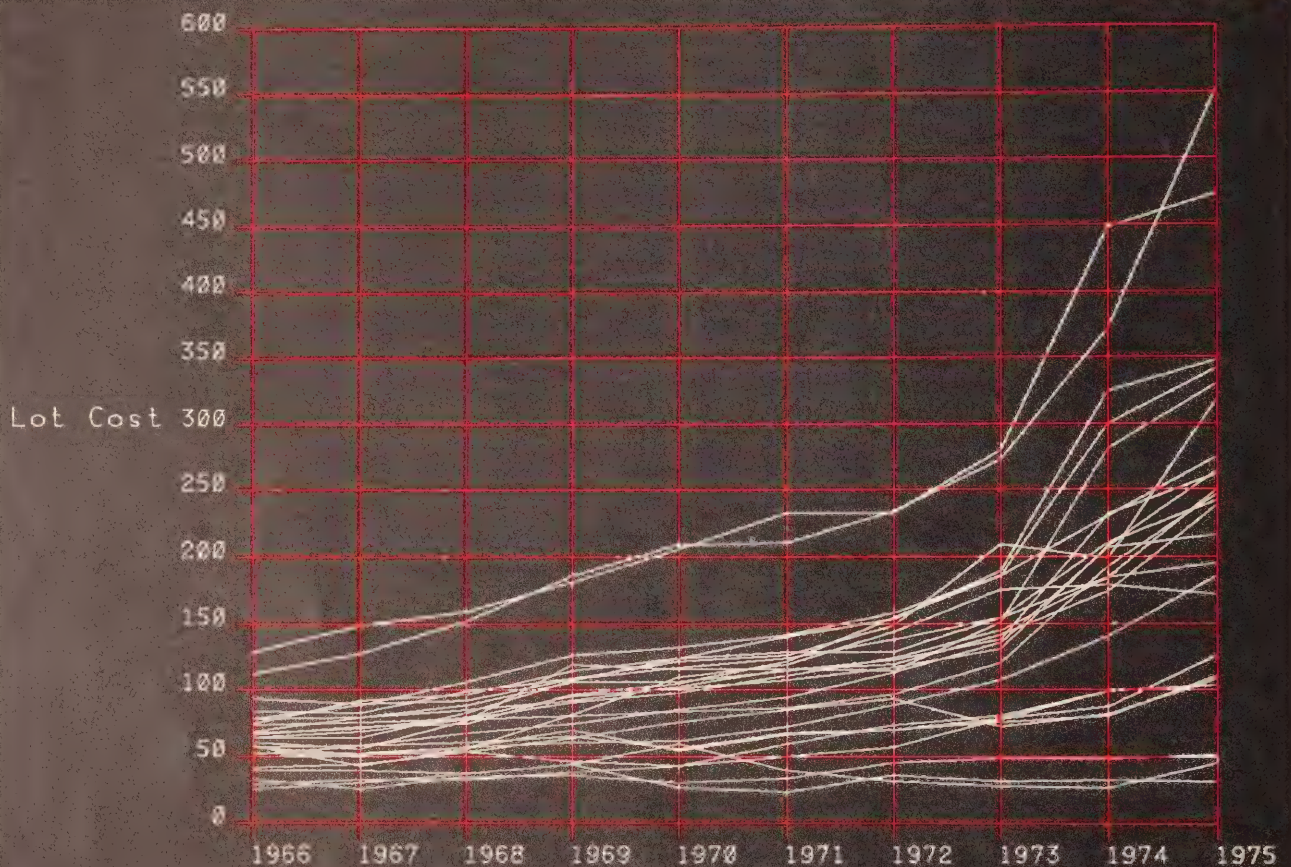
Index to Figures and Tables

1.	INTRODUCTION	
Figure 1.A	Canadian Lot Costs Soar	1
2.	THE REAL ESTATE BOOM OF 1972-1975 WITH HINDSIGHT	
Table 2.A	Percent Changes In Average Cost Per Foot Frontage Of Fully Paid, Fully Serviced Lots For New Housing Financed Under The National Housing Act	7
Figure 2.A(1)	Changes In Lot Costs In 25 Urban Areas	8
Figure 2.A(2)	Changes In Lot Costs By Region	9
Figure 2.B(1)	Lot Costs Versus House Prices	10
Figure 2.B(2)	Lot Costs Versus House Prices (Three Dimensional Version Of Figure 2.B(1))	11
Figure 2.B(3)	Lot Costs Versus House Prices By Region	12
Figure 2.C	MLS House Prices By Region	15
Figure 2.D	The Effects Of A 50% Cut In New Housing Production On The Housing Stock	16
Figure 2.E	New And Used House Prices Move Closely Together	18
Figure 2.F	Inflation Soars	23
Figure 2.G	Incomes Soar	24
Figure 2.H	The Stock Market Plummets	25
Figure 2.I	Number of Young Families Increases	26
Figure 2.J	Amounts Of Downpayments Decrease	27
Figure 2.K	Volume Of Mortgage Money Soars	28
Figure 2.L	Real Mortgage Rates Plummet	29
Figure 2.M	The Process Of Asset Revaluation	30
4.	LONG-RUN PRICE DETERMINANTS: PUBLIC SECTOR CONTROVERSIES	
Figure 4.A	Regina: Lot Prices Versus House Prices	36
Figure 4.B	Winnipeg: Lot Prices Versus House Prices	37
Figure 4.C	Lot Prices Soar Beyond Servicing Costs During The Boom	46

Index to Figures and Tables

Figure 4.D	Servicing Cost Increases Can Be Controlled	48
Table 4.A	Purchases By Ontario Housing Corporation Township Of Gloucester (Ottawa Region)	54
Table 4.B	An Illustration Of The Irrelevance Of Public Versus Private Land Ownership For Short-Run Housing Price Fluctuations	59
Figure 4.E	Public Land Ownership Had No Discernible Effect On MLS House Prices	60
Figure 4.F	Public Land Ownership Had No Discernible Effect On NHA House Prices	61
5.	LONG-RUN PRICE DETERMINANTS: PRIVATE SECTOR CONTROVERSIES	
Figure 5.A	Profitability Of 33 Completed Subdivision Projects In Ontario	65
Table 5.A	Ownership Concentration: Nominal And Effective Ownership Statistics	69
Figure 5.B	Decision Tree For Assessing Industry Structure	74
APPENDIX 1.	CRITICAL REVIEW: HOW IT WORKED	
Figure A.1	Critical Review: The Adversarial Process	91

Figure 1.A Canadian Lot Costs Soar



Title: Average Cost (\$) per Foot Frontage of
Serviced Lots in 25 Urban Areas

Source: Chapter 2 and Appendix 1 of Volume Two

1. Introduction

1.1 Why The Task Force Was Created

Between 1972 and 1975, land and housing prices in most Canadian cities skyrocketed. Average lot prices rose at a rate far faster than the rate of inflation for other goods. This was a dramatic economic phenomenon in Canada, with important social and political implications.

The government of Canada, eight of the provincial governments and the North West Territories asked us to examine the supply and price of serviced land across Canada in order to replace the tangle of competing claims and polemics with factual information and analysis.

Our terms of reference were cautious: they required us to limit ourselves to "findings" and "conclusions" and to avoid recommendations.

They correctly made the crucial distinction between price escalations and price levels. This Report therefore analyses both the *extreme short-run price escalations of 1972-1975* and *increasing long-run price levels*.

One was short run, the other is long run. One was characterized by extreme increases, the other by high levels. One ended in the past; the other exists today and may continue tomorrow. They are caused by different sets of factors and can be analysed separately. But they are also related: governments would have less concern about the recent price increases if they had not led to high price levels which are perceived as a serious social problem.

1.2 Our Three Basic Purposes

In making our decisions about research design and report structure we were guided by three basic purposes.

Response To The Terms Of Reference

First, our findings should help explain both recent price escalations and long-term price levels. They should thereby encourage government policymakers at all levels to consider in advance the cost/consequences of their various decisions on land and housing prices.

Tools For The Policymakers

Secondly, we should provide policymakers with tools for future research. Therefore, we have created standard research methodologies for the profitability of individual subdivisions, citizen resistance to development, concentration of land ownership, infill rezoning and servicing standards and costs.

Additionally, for the first time we have created data sets on these topics which are comparable

1. Introduction

across the country. Comparability is important because policymakers and others want to know how well or badly they are doing in relation to how others are doing. The methodologies and data sets will be published in a future Volume Three, Research Studies.

Facts For The Public

Thirdly, we should explain our findings in terms the public can understand. In Volume One we have therefore simplified our findings, without distorting them. We have tried to avoid the maddening abstractions of the scholars.

1.3 How We Tackled Our Task

Off-The-Shelf Data

Limitations of time and money made us turn first to readily available, off-the-shelf data. This hunting ground proved largely barren. Most of the published data are irrelevant to price-related questions, and most of the relevant data are unpublished. Much of these data appear to be numbers that are easy to collect rather than numbers that are needed. How else explain the almost total lack of data on lot servicing costs and on the volumes of land in various stages of the subdivision approval process? How else explain the many random collections of facts with inadequate definition as to why they were collected?

The existing data have another problem: they are often non-comparable across urban areas. For these reasons, we had to commit many resources to collecting original data.

National Coverage Versus Case Studies

All original data collection is costly in time and treasure. Nevertheless, in concentration of land ownership, municipal servicing standards and lot servicing costs, we were able to achieve widespread coverage. In other topics, such as land assembly, infill rezoning, the subdivision approval process, citizen resistance to development and individual subdivision profits, we had to sacrifice comprehensive coverage in favour of case studies. We had a sharply limited ability to collect in months original data that the federal, provincial and large municipal governments have not been able to collect over years.

As a result we tried to do small studies well, opting for illustrative depth in a restricted sample size. The weakness of case studies is that they cannot claim to be representative. We acknowledge this unavoidable weakness. But case studies are illustrative of the broader trends which many observers believe are at work, not necessarily in every urban area, but generally across the country. They therefore permit suggestive conclusions about overall markets not limited

1. Introduction

to the particular markets studied. Our case studies are too few in number to yield representative conclusions at this time; but if governments applied our standardized methods on a continuing basis, they could quickly build a representative data base.

National Versus Local Factors

A crucial distinction must be made between national and local levels of activity. At any given level, certain forces lie within a given government's control (for example servicing standards at the local level), while others lie outside it. Distinguishing between local and national factors acting on land prices became, inevitably, one of our principal preoccupations.

Critical Review

All contributors were required to submit their work to a process of intense critical review by panels of experts from a wide variety of disciplines and occupations: economists, municipal politicians, senior federal and provincial policymakers, geographers, consulting engineers, land market analysts, land use planners, social policy analysts, financial analysts, developers and accountants. Often the review sessions were face-to-face confrontations, recorded on tape.

This process was designed to minimize error, reduce omissions and prevent us from acquiring the biases of the contributors.

Economic Questions Only

Our terms of reference are ambitious in the extreme, and the *economic* questions they pose are complex. Therefore, [we were compelled to limit our scope to the economic causes of land price changes and unfortunately to largely ignore their social implications.

For the same reason we have tried to confine ourselves to identifying the cost/consequences of government policies on land and housing prices without characterizing them as good or bad. Clearly many government decisions that raise prices also improve the urban environment, or serve other important purposes not related to land prices. We identify some of those trade-offs without imposing our judgments on them.

2. The Real Estate Boom of 1972-1975 with Hindsight

2.1 How Real Was The Real Estate Boom?

Table 2.A demonstrates that during the boom of 1972-1975, on average in 25 urban areas across the country lot prices increased at a rate over 40% *greater than the general rate of inflation*. Lot prices exploded relative to prices of other goods.

These data demonstrate a second striking feature about the boom: it was widespread.(1) From Ottawa to the west coast the real rate of increase was more than 50% ahead of general inflation, and the nominal rate was 98%. Even in the Atlantic provinces the real rate was more than 10% ahead of general inflation and the nominal rate reached 47%.

The last row of Table 2.A also shows that the real price of lots rose on average across the country in all three time periods summarized: 1966-1969, 1969-1972 and 1972-1975. Clearly, lots were becoming more expensive relative to other goods throughout the entire decade.

Figure 2.A(1) presents the price changes set out in Table 2.A three-dimensionally. Urban areas are described from the west coast to the east. Lot costs are measured vertically, and time from past to present is represented in depth from front to rear. Figure 2.A(2) organizes these price changes two-dimensionally, by region.

Figure 2.B(1) demonstrates a major reason why the Task Force was asked to study lot prices, not housing prices. It shows that in every urban area studied outside of Quebec, lot costs have increased significantly as a component of housing prices. This means that lot costs have risen much faster than the costs of labour and building materials. Figure 2.B(2) presents these cost changes three-dimensionally, and Figure 2.B(3) presents them two-dimensionally, by region.

2.2 Popular "Conspiracy" Theories Finding 1

WE FIND THAT THE LAND AND HOUSE PRICE EXPLOSION OF THE BOOM OF 1972-1975 WAS NOT CAUSED BY:

- . PROVINCIAL AND MUNICIPAL "RED TAPE";
- . HIGH MUNICIPAL LOT LEVIES, "GOLDPLATED" MUNICIPAL SERVICES OR MUNICIPALITIES PROTECTING THEIR

-
- (1) Quebec, with slower population growth and lower expectations, was the one exception to the general lot price explosion. The reasons are discussed more fully in Chapters 5, 8 and 13 of Volume Two. But as is shown in Chapter 2 of Volume Two, Quebec did not escape its own modest house price boom; over a three-year period, new houses financed under the National Housing Act (NHA) increased 13% in real terms and 50% in nominal terms.

2. The Real Estate Boom of 1972-1975 with Hindsight

PROPERTY TAX BASE;

- . CITIZEN RESISTANCE TO NEW DEVELOPMENT; OR
- . GOVERNMENT TAXATION POLICIES.

BUT EACH OF THESE FACTORS HAS CONTRIBUTED AND WILL CONTRIBUTE TO HIGH PRICE LEVELS.

Finding 2 WE FURTHER FIND THAT THE LAND AND HOUSE PRICE EXPLOSION WAS NOT CAUSED BY EITHER HIGH PROFITS OR MONOPOLISTIC DEVELOPERS.

We emphasize these findings at the beginning of the Report to refute the popular "conspiracy" theories which are prevalent to explain the rapid price increases of the boom years 1972-1975.

One is the "Monopoly-Developer" theory. It holds that the developers could withhold lots, fix prices, rig markets, subvert governments and probably devalue our currency.

Another is the "Government Red-Tape" theory. It cherishes equivalent fantasies about the lust for power of the "new class" - the zealous bureaucrats who strangled the production of new lots.

Both theories are based on the same assumption. Both assert that the boom was caused by disruptions in the production of new housing. Both assume that cuts in the production of new housing can lead to large increases in the price of all housing in the short period of two to three years.

These and the other supply-restriction theories listed in Finding 1 have been used to explain all or part of the land price boom. Each explanation is different only in blaming a different group: developers, provincial governments, the federal government, municipal councils, municipal engineers, municipal and provincial planners and organized ratepayers.

But each is *similar* in focusing on restrictions in the production of new housing.

Where the conspiracy theories are so rampant, the stakes so high, the interests so competitive, and so many analysts unable to agree with each other, we recognize the difficulty of persuading the competing interests that these and other common beliefs about the causes of the boom are wrong. Our conclusion nonetheless is that they are not adequate to explain the extreme price increases of the boom. They simply fail to account for the facts.

Table 2.A

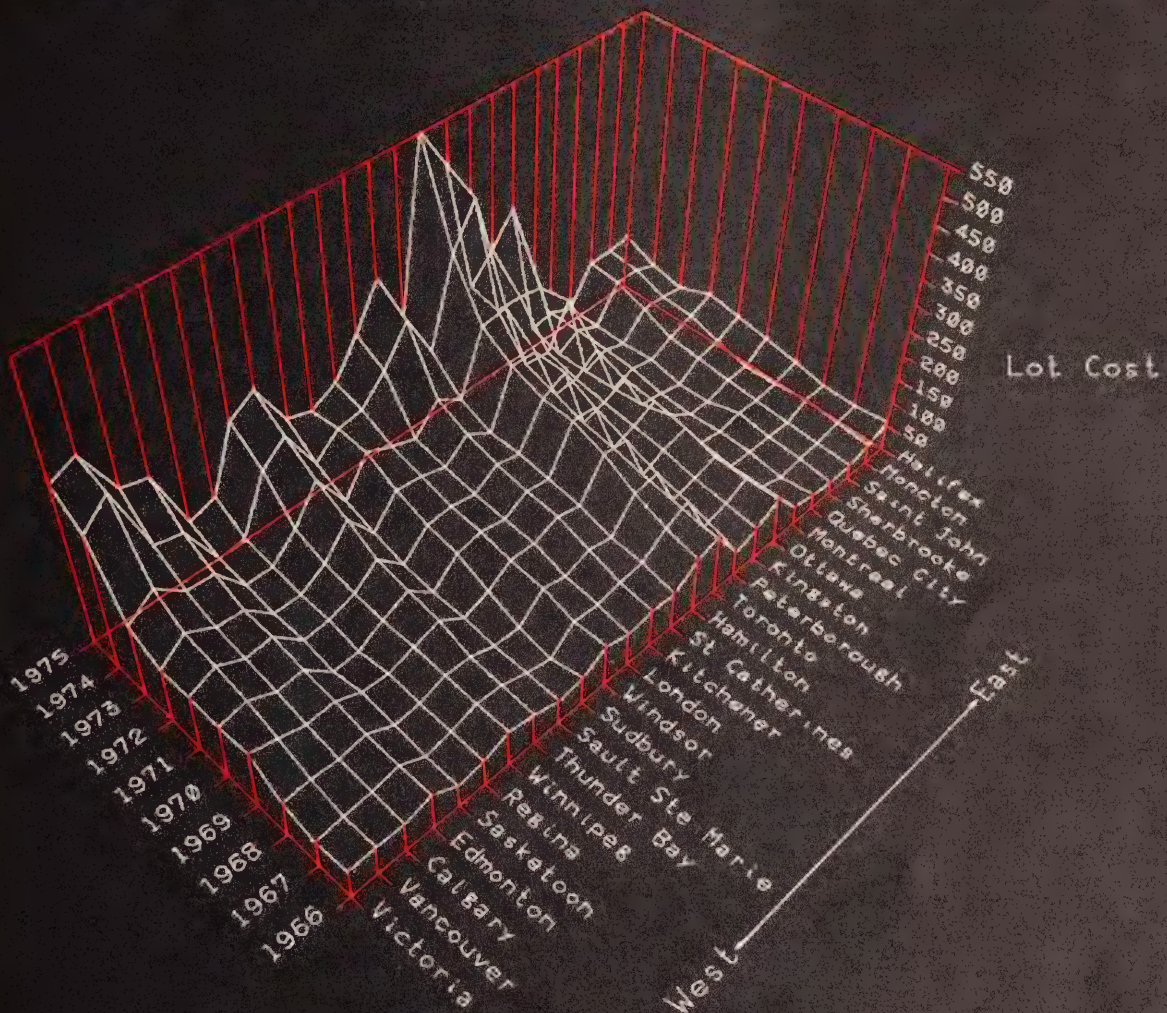
Percent Changes In Average Cost Per Foot
Frontage Of Fully Paid, Fully Serviced
Lots For New Housing Financed Under The
National Housing Act

	Percent Change 1966-1969		Percent Change 1969-1972		Percent Change 1972-1975	
	Nominal	Real	Nominal	Real	Nominal	Real
Ottawa to West Coast	42.4	26.3	29.4	16.1	102.9	53.4
Montreal to East Coast	25.2	11.1	21.8	9.3	31.4	-0.6
Atlantic Provinces	17.5	4.3	51.2	35.7	47.0	11.2
Quebec	32.8	17.8	-7.7	-17.1	15.9	-12.3
Ontario	42.8	26.7	35.5	21.6	95.2	47.6
Manitoba and Saskatchewan	21.5	7.8	9.2	-2.0	98.2	49.9
Alberta and British Columbia	56.8	39.1	26.1	13.2	129.4	73.5
Total 25 Urban Areas	38.2	22.7	27.5	14.5	85.7	40.5

SOURCE: Chapter 2 and Appendix 1 of Volume Two

NOTE: Table 2.A summarizes the recent past by presenting lot price changes by regions for three time periods: 1966-1969, 1969-1972 and 1972-1975. It records prices in two ways. The "nominal" prices are actual prices. The "real" prices are nominal prices which have been corrected for inflation. The real prices are important because they show the changes in lot prices relative to the "average" price changes in the economy.

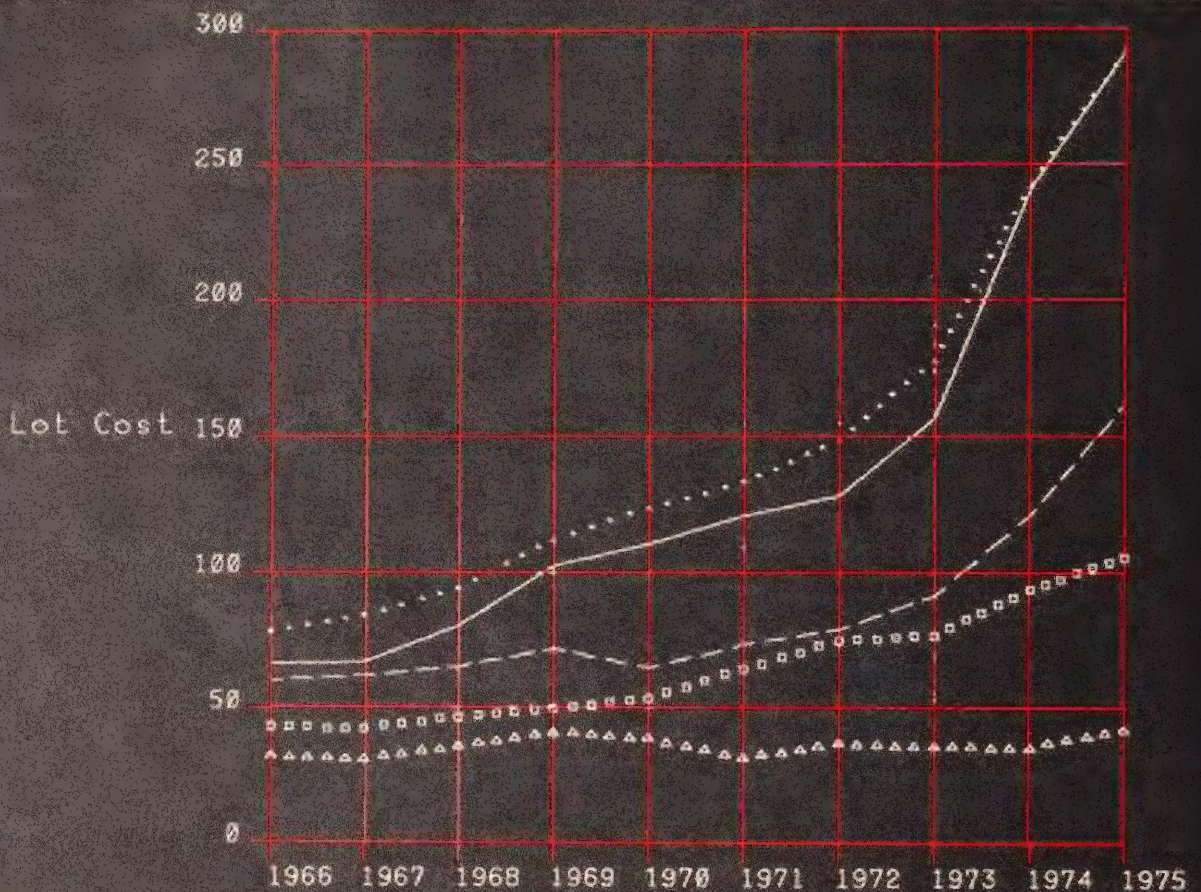
Figure 2.A(1) Changes In Lot Costs



Title: Average Cost (\$) per Foot Frontage of Serviced Lots in 25 Urban Areas

Source: Chapter 2 and Appendix 1 of Volume Two






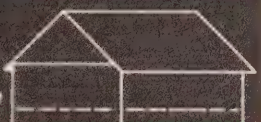

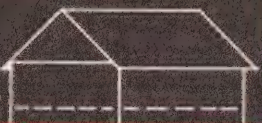

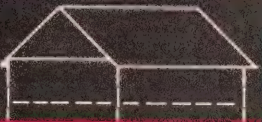
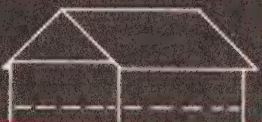
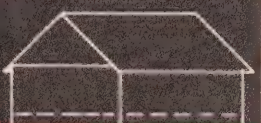







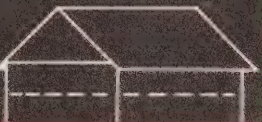

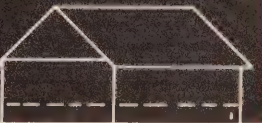


Figure 2.A(2) Changes In Lot Costs



Title: Average Cost (\$) per Foot Frontage for 5 Regions
 ————— Alberta-British Columbia (Solid)
 - - - - - Manitoba-Saskatchewan (Dashed)
 Ontario (Dotted)
 ▲▲▲▲▲ Quebec (Triangle)
 □□□□□ Atlantic Provinces (Square)

Source: Chapter 2 and Appendix 1 of Volume Two

Table 2.B(1) Lot Costs Versus House Prices

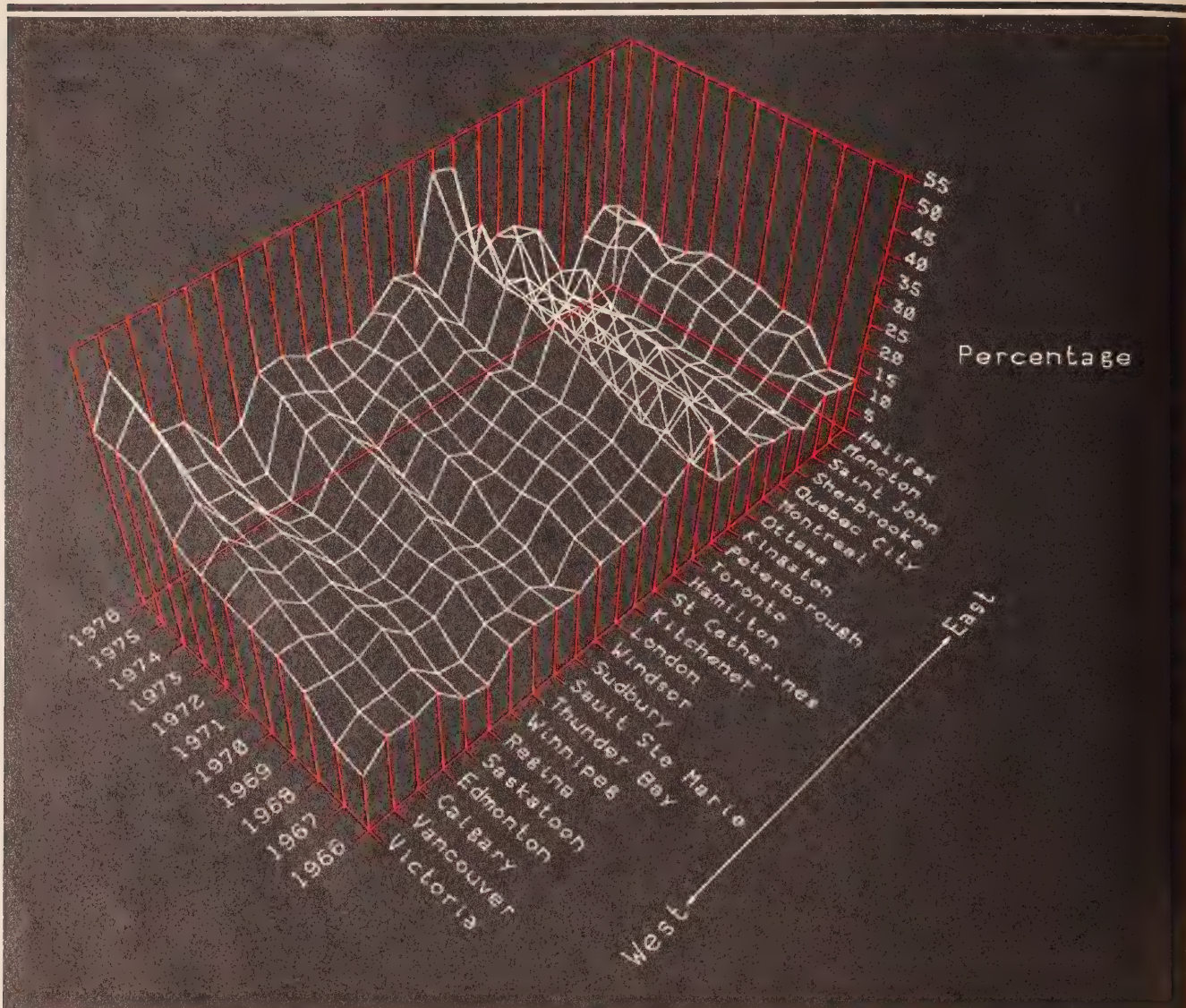
	1966	1971	1976
Ottawa to West Coast	18.6 	25.1 	33.4 
Montreal to East Coast	13.1 	15.4 	14.7 
Atlantic Provinces	13.4 	18.7 	19.6 
Quebec	12.7 	12.0 	9.9 
Ontario	19.8 	26.0 	33.7 
Manitoba Saskatchewan	14.1 	19.2 	26.2 
Alberta British Columbia	18.1 	26.8 	37.7 
All 25 Urban Areas	17.2 	22.8 	28.9 

Lot Cost as a Percentage of Total Cost:* New Single Family Detached Dwellings Financed Under the National Housing Act
Selected Averages of Urban Areas

Source: Chapter 2 and Appendix 1 of Volume Two

- * The term cost in this and other NHA housing price data refers to the cost to the consumer (i.e. price) rather than the cost of production. This terminology is awkward but represents the standard terminology of NHA data sets.

Figure 2.B(2) Lot Costs Versus House Prices

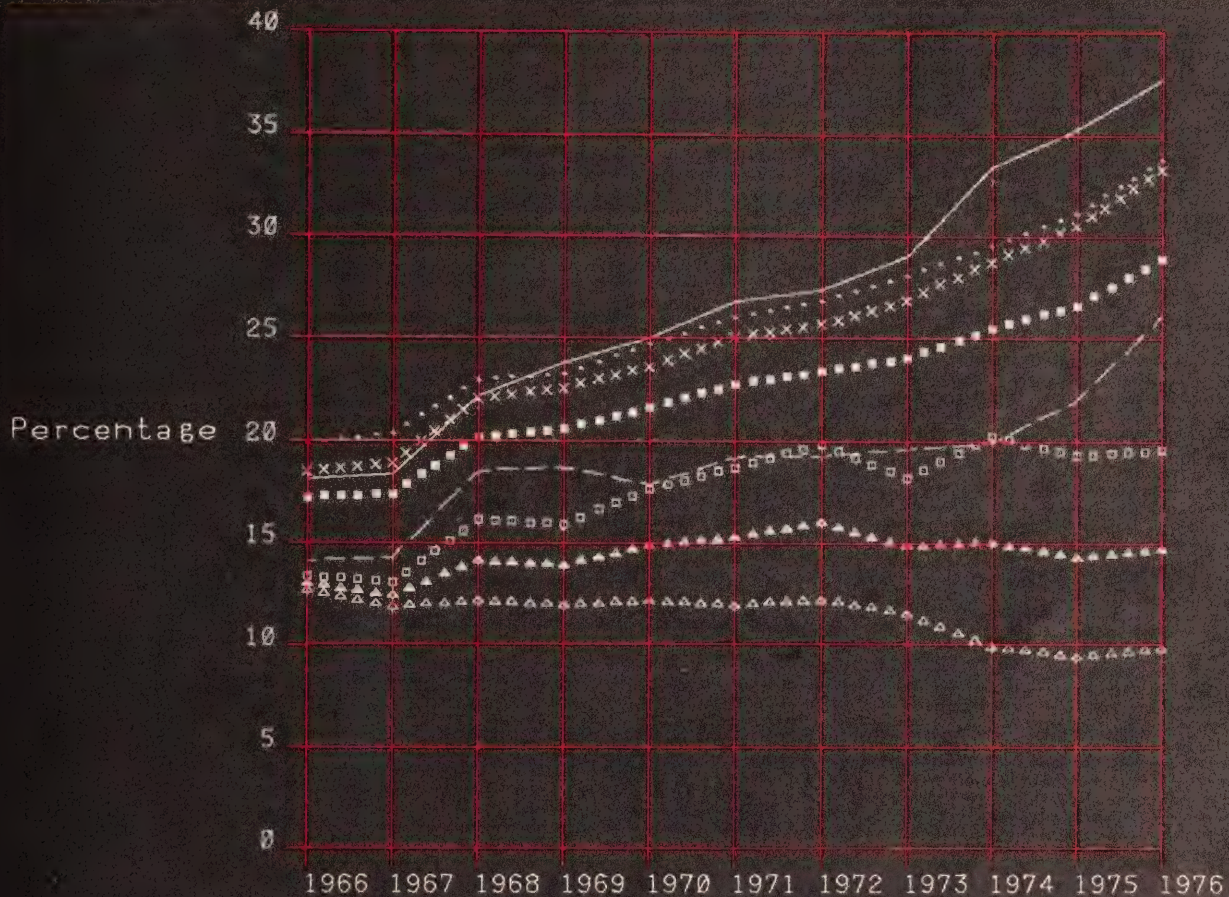


Title: Lot Cost as a Percentage of Total Cost: New Single Family Detached Dwellings Financed under the National Housing Act
Selected Averages of Urban Areas

Source: Chapter 2 and Appendix 1 of Volume Two

Note: The term cost in this and other NHA housing price data refers to the cost to the consumer (i.e. price) rather than the cost of production. This terminology is awkward but represents the standard terminology of NHA sets.

Figure 2.B (3) Lot Costs Versus House Prices



Title: Lot Cost as a Percentage of Total Cost for Selected Regions:
New Single Family Detached Dwellings Financed under the
National Housing Act

— Alberta-British Columbia
 - - - - - Manitoba-Saskatchewan
 ••••• Ontario
 ▲▲▲▲▲ Quebec
 □□□□□ Atlantic Provinces
 ××××× Western Region
 ▲▲▲▲▲ Eastern Region
 ■■■■■ All Regions

Source: Chapter 2 and Appendix 1 of Volume Two

Note: The term cost in this and other NHA housing price data refers to the cost to the consumer (i.e. price) rather than the cost of production. This terminology is awkward but represents the standard terminology of NHA data sets.

2. The Real Estate Boom of 1972-1975 with Hindsight

2.3 Looking For Answers

If It Was So Bad,
Why Was It So Good?

In fact, the evidence contradicts the argument that production of new housing was cut during the boom.

Housing starts in 1966 were 134,500. In 1973, only eight years later, they were 268,500 - twice as many.

It took the *five* years from 1966 to 1970 to start 896,000 units. But in the *four* years from 1972 to 1975, the total number of housing starts was 972,000, 76,000 units more.

Even more striking is the increase in the starts of single detached houses; from 1971 to 1975, 591,300 were started, up from 367,700 during the preceding five years - an increase of 61%.

Developers produced very large increases in lots. And governments, planners, municipalities and rate-payers permitted them to be produced. If the planning gauntlet was tougher and longer than it had been, many more projects still got through.

Of course these production figures cannot tell us how many more lots would have been produced if there were no gauntlet at all, or if it were shorter or less complex.

Finding 3

BUT WHEN PRODUCTION LEVELS WERE UNPRECEDENTED, HUGE PRICE INCREASES CANNOT BE EXPLAINED BY ALLEGED CUTBACKS IN PRODUCTION.

The Boom Was National,
But Production Is Local

The fact that the boom was widespread casts additional doubt upon the various supply restriction theories.

The reason is that the major factors that affect supply are local. Provincial and municipal approval processes, municipal attitudes to development, activist ratepayer levels and the like, vary enormously among the provinces, among cities within each province and even within individual cities over time.

For example, Regina has only a few major developers, the Toronto area has many. Regina can process even complex subdivisions in three months; Ontario can take one to two years or more. Their local supply conditions are clearly different. But each experienced huge house price increases during the boom, even allowing for the depressed market conditions in Regina at the beginning of the 1970's.

2. The Real Estate Boom of 1972-1975 with Hindsight

Winnipeg became "Unicity", and lot approvals were virtually frozen for a year right at the beginning of the boom; the Vancouver area municipalities were not unified, and many grew rapidly throughout the boom. Their supply conditions too were very different, but each experienced huge price increases.

Figure 2.C presents MLS dwelling prices over time for 25 urban areas, organized by region.⁽¹⁾ It shows that even with significant variations in Quebec and the Atlantic provinces, the price boom was a *national* phenomenon, and occurred with equal force in many localities experiencing drastically different supply conditions. This strongly suggests that the origins of the boom were themselves national in character, and did not reflect local supply conditions except in a marginal way. All of our research in this Report points to this conclusion.

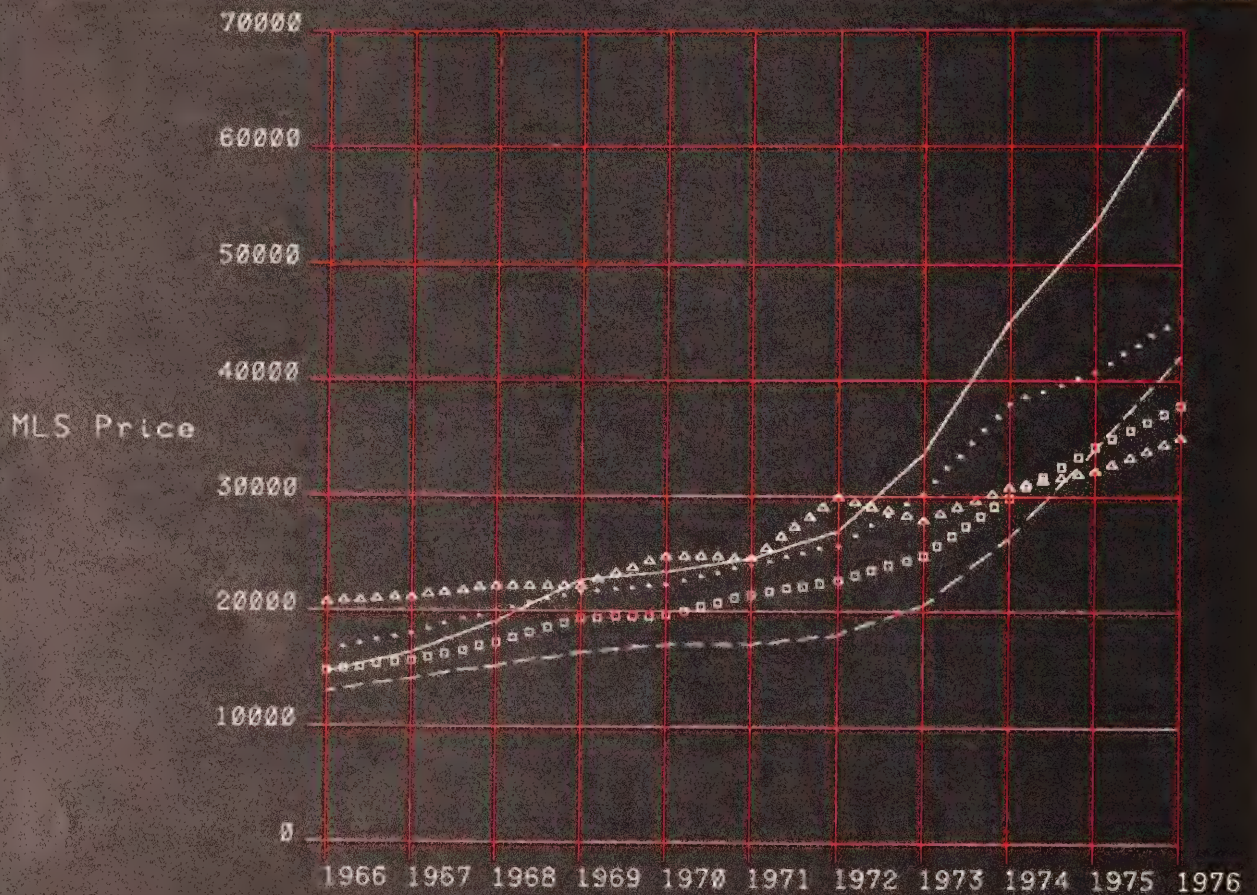
In The Short Run,
The 5% Tail Cannot
Wag The 95% Dog

In addition to the evidence that production was unprecedented and the boom national, analysis of the relationship of the flow of new housing to the stock of existing housing also demonstrates why the various supply-restriction theories cannot explain the boom. In the short term, new housing production does not substantially affect the total housing market. In most growing urban areas, the annual production of new dwelling units is only about 5% of existing dwelling units. This dominance of the existing stock in the short run is shown in Figure 2.D. Even if the supply of new housing in a given year were reduced by the extreme amount of 50% (whether by a "monopoly" developer or by government "red tape"), the total supply of housing that would otherwise have been available would be reduced by only 2.5%.

This shortfall in new house production would, of course, cause a moderate increase in prices, which would in turn cause a more intense utilization of the existing stock; housing previously holding 100 households might absorb, say, 102 households. But even this exaggerated cut-back of 50% in *new* housing could not possibly push prices of *all* housing up by 40% or more in a single year, as occurred in many areas during the boom.

(1) MLS Dwelling Prices are prices of houses sold through the Multiple Listing Service. These statistics are dominated by resales as distinct from new houses.

Figure 2.C MLS House Prices by Region



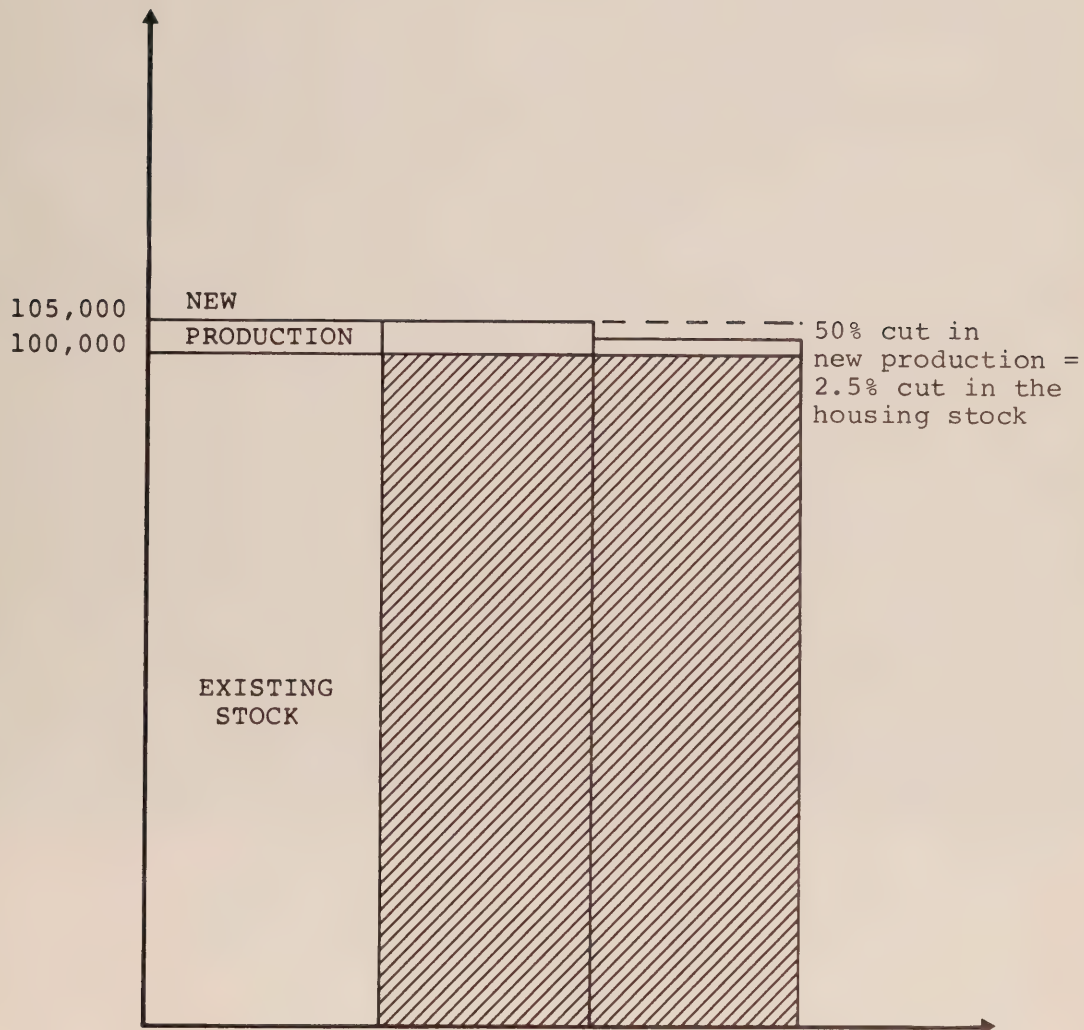
Title: Average Price of MLS Dwellings for Selected Regions
 ————— Alberta-British Columbia
 ----- Manitoba-Saskatchewan
 Ontario
 △ △ △ Quebec
 □ □ □ Atlantic Provinces

Source: Chapter 2 and Appendix 1 of Volume Two

Note: MLS Dwelling Prices are prices of houses sold through the Multiple Listing Services. These statistics are dominated by resales as distinct from new houses.

Figure 2.D In The Short Run, The 5% Tail
Cannot Wag the 95% Dog

THE EFFECTS OF A 50% CUT IN NEW HOUSING PRODUCTION
ON THE HOUSING STOCK (ASSUMING NEW PRODUCTION WAS
ORIGINALLY 5% OF THE STOCK)



SOURCE: Task Force Staff

2. The Real Estate Boom of 1972-1975 with Hindsight

If The Price Is Right
.....

How high would prices rise after a large cut in new production? The answer depends upon the degree to which potential and existing homeowners look on new and used housing as substitutes for each other. If new and used houses were poor substitutes, a large cut in new production would cause large increases in the price of new housing, but would not affect the price of existing housing. If they were good substitutes, a large cut in new production would cause small increases in both new and existing housing.

In fact, we found that the prices of new and used houses move very closely together.⁽¹⁾ In Figure 2.E, each point associates the average price of a new NHA dwelling with the average price of an MLS dwelling in a particular city for a particular year; higher MLS prices clearly tend to be associated with higher NHA prices, showing that the prices of these two groups of dwellings move very closely together. This demonstrates that if the price is right, enough people are prepared to substitute living in one neighbourhood for another neighbourhood to make those neighbourhoods, like Fords and Chevs, good substitutes for each other. Therefore, large cuts in the production of new housing should lead to relatively small increases in the price of all housing in the first year. In Figure 2.D the 50% cut in new production represents only a 2.5% cut in the *total* supply of housing for pricing purposes.

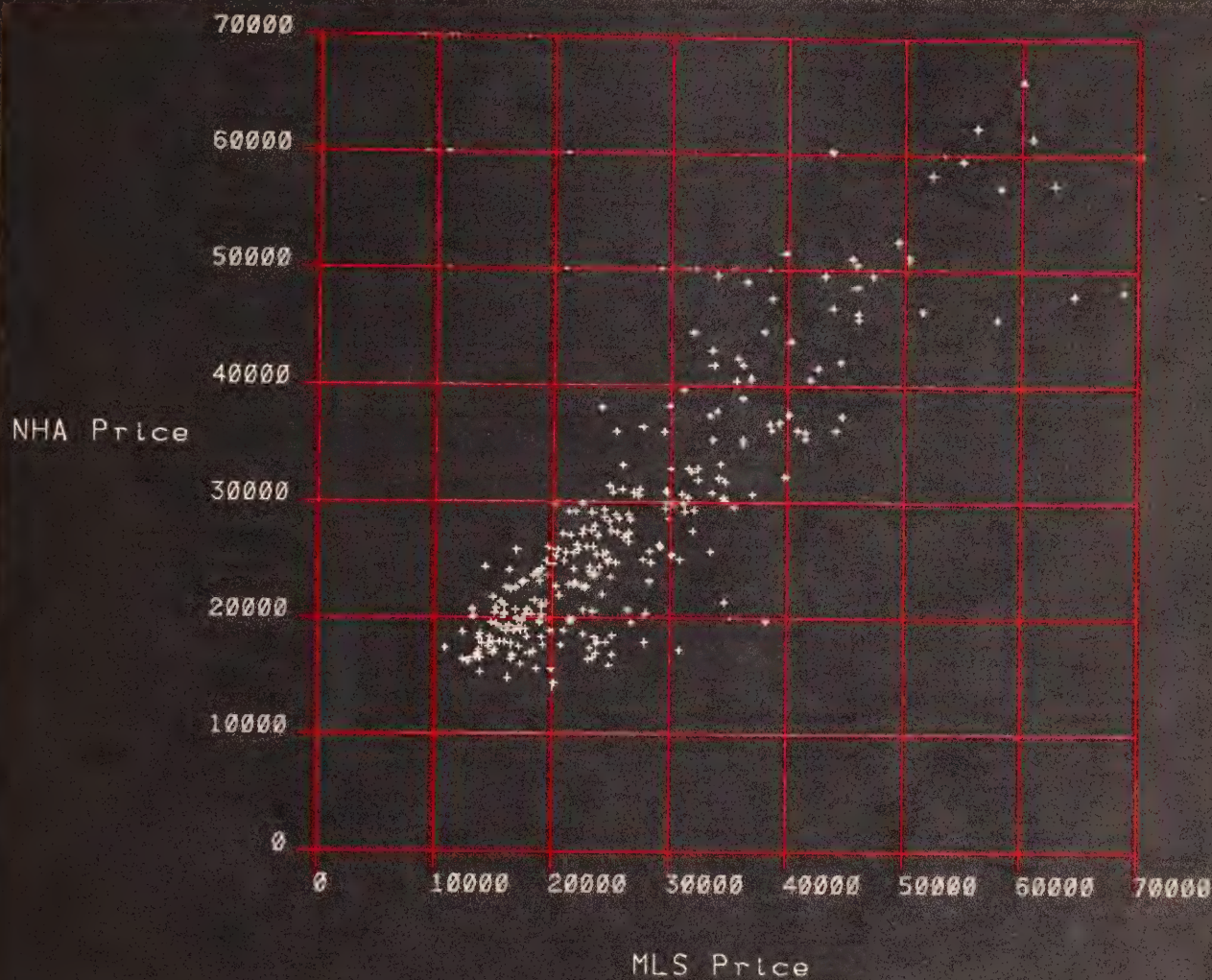
Anglophones, Francophones
And Westmount

Current Canadian experience confirms the analysis that housing markets are not segmented. Westmount in Montreal has always been considered an almost exclusively Anglophone market. Recently, house prices there have dropped sharply and many Francophones have quickly responded by moving in. If the Anglophone and Francophone markets were in fact completely and inevitably segmented, Francophones would not be moving into Westmount. That they are now doing so demonstrates that if the price is right, markets are substitutes for each other rather than segmented.

Other supporting evidence is that most new housing is marketed in clusters at particular times, not smoothly over an entire year. Yet house prices follow gradual curves throughout the year which in no way reflect these erratic additions to supply. The reason must be that the flow of new housing is diluted by the stock of existing housing.

(1) Reference: Chapter 4, Volume Two

Figure 2.E New and Used House Prices Move
Closely Together



Title: MLS Prices vs. NHA Prices for 25 Urban Areas, 1966-1976

Source: Chapter 2 and Appendix 1 of Volume Two

2. The Real Estate Boom of 1972-1975 with Hindsight

We are not arguing that new and used houses sell for the same prices. All houses differ in lot size, location, structure size and quality, age, neighbourhood amenities, layout and the like; that is why they differ in price. But recent studies in Bristol, England and Winnipeg show that no matter how much individual house prices may differ across a varied urban area, the market gives *each* of these individual characteristics the *same* value across that urban area.(1) The price of any given house reflects the total value of its individual characteristics.

Builders therefore cannot value the individual characteristics of their new housing independently of the values those characteristics have already been given in the existing housing.

Interchangeable Housing, Interdependent Markets

Therefore, no matter how small its volume, new housing introduced into an existing market must be priced close to the level of existing supplies with similar characteristics. Otherwise, it will not sell and demand will be met by more intensive use of existing housing. As long as this high degree of substitutibility exists, it is impossible to introduce new housing into an existing market at uncompetitive prices. The 5% tail cannot wag the 95% dog *in the short run*.

The principle is simply that the size of the existing stock determines the degree to which new supplies can exert an influence on prices. Most people automatically recognize the principle when applied in practice. They would agree that adding or subtracting 100 houses in the Toronto market would have a negligible influence because the existing supply is proportionately enormous, but adding or subtracting 100 houses in Fort McLeod would have a more substantial impact on prices. The difference is the dilution effect of existing alternative supplies. A big market easily dilutes the impact of changes that constitute mere fractions of the existing supply.

Finding 4 DURING THE BOOM, LOT PRICES IN SOME PLACES IN SOME YEARS ROSE 30% TO 40%. NEITHER DEVELOPERS NOR MUNICIPALITIES, NEITHER RATEPAYERS NOR PLANNERS, COULD SUFFICIENTLY STRANGLE SUPPLY FOR THE SHORT YEARS OF THE BOOM TO EXPLAIN EITHER PRICE RISES OF THAT MAGNITUDE OR THEIR OCCURRENCE ACROSS MUCH OF THE COUNTRY. THE REASON IS THAT THEY CAN RESTRICT ONLY NEW HOUSING, NOT EXISTING HOUSING. YET IN MOST

(1) Reference: Chapter 4, Volume Two

2. The Real Estate Boom of 1972-1975 with Hindsight

GROWING URBAN AREAS ABOUT 95% OF THE HOUSING STOCK IS FIXED IN THE SHORT RUN WHILE THE ANNUAL PRODUCTION OF NEW HOUSING UNITS IS ONLY ABOUT 5% OF THE EXISTING STOCK. BECAUSE THE EXISTING STOCK DOMINATES THE MARKET IN THE SHORT RUN, NEW HOUSING PRODUCTION DOES NOT SUBSTANTIALLY AFFECT THE TOTAL HOUSING MARKET OVER SHORT PERIODS OF TIME. THE 5% TAIL CANNOT WAG THE 95% DOG IN THE SHORT RUN.

THIS IS NOT TO SUGGEST THAT IF THEY EXIST, "MONOPOLISTIC" DEVELOPERS AND "SELFISH" MUNICIPALITIES, GOVERNMENT "BUREAUCRATS" AND "PARANOID" RATEPAYERS, OUGHT NOT TO CAUSE CONCERN. HOWEVER, THEIR PRODUCTION RESTRICTIONS, IF ANY, WOULD GRADUALLY CAUSE HIGHER LONG-RUN PRICE LEVELS, NOT THE RAPID INCREASES OF THE BOOM.

The second half of our Report deals with these long-run price determinants. But first, having referred to the factors which did not create the boom, let us turn to the factors which did.

2.4 The Surge In Housing Demand

(We have so far emphasized two factors about the boom: it was widespread and it could not have been caused by local supply conditions.) These compel us to look to the demand side of the equation. When we do, we find that just before and during the boom, an extraordinary number of things happened at once to stimulate demand extraordinarily.

✓ Inflation escalated (see Figure 2.F).

✓ Real income exploded (see Figure 2.G).

✓ The stock market dropped sharply (see Figure 2.H).

✓ The baby boom of the 40's and 50's created a young families boom in the early 70's (see Figure 2.I).

The only major way for most people to beat the new federal capital gains tax of 1971 was to buy, occupy and sell a house.

Through changes in federal law, downpayments became very low (see Figure 2.J), and so the largest mortgages ever became possible. Because mortgage money was more plentiful than ever, mortgages became easy to get (see Figure 2.K). Because the nominal interest rate on mortgages rose less than inflation, they became cheaper to pay for in real dollars (see Figure 2.L).

2.5 Asset Revaluation - The Real Reason } Behind The Boom Land Don't Rust

Land is durable. It is not used up like ice cream, but returns benefits over long periods of time. Its present value is therefore in large part determined by its expected future income and asset

2. The Real Estate Boom of 1972-1975 with Hindsight

returns.

A Great Deal

An explosion in real income, high general inflation, the sharp decline of returns to alternative assets on the stock market, more mortgage money than ever before and at cheaper real rates, all combined *at once* powerfully to stimulate the demand for housing and land on top of stimulation already provided by smaller downpayment requirements, exemption from capital gains tax and larger numbers of young households. These factors caused homeowners and potential buyers to believe that *future* prices would continue to increase at then *current* rates. Buyers projected past price increases into expected future price increases. Since expectations of future price increases raised the expected return from owning land and housing, the demand for both increased. When the price of butter goes up demand goes down, but when the price of oil company shares goes up demand for those shares often goes up in expectation of future increases. In this way, strong initial increases in demand led to changing expectations which led to a revaluation of the housing stock.

As a result, buying housing and land came to be considered a great deal.

Great Expectations

Those considering buying homes or land were now willing to pay more while those considering selling demanded more. At that point, prices became determined by what was happening not "out there" but in our heads. Only the perceptions in our heads can change fast enough, overnight, to explain these extraordinarily fast increases. And that's what it came down to, just an overnight change of expectations about the value of land and housing in the future. People stopped thinking of housing primarily as "shelter" and started thinking of it more as "investment".

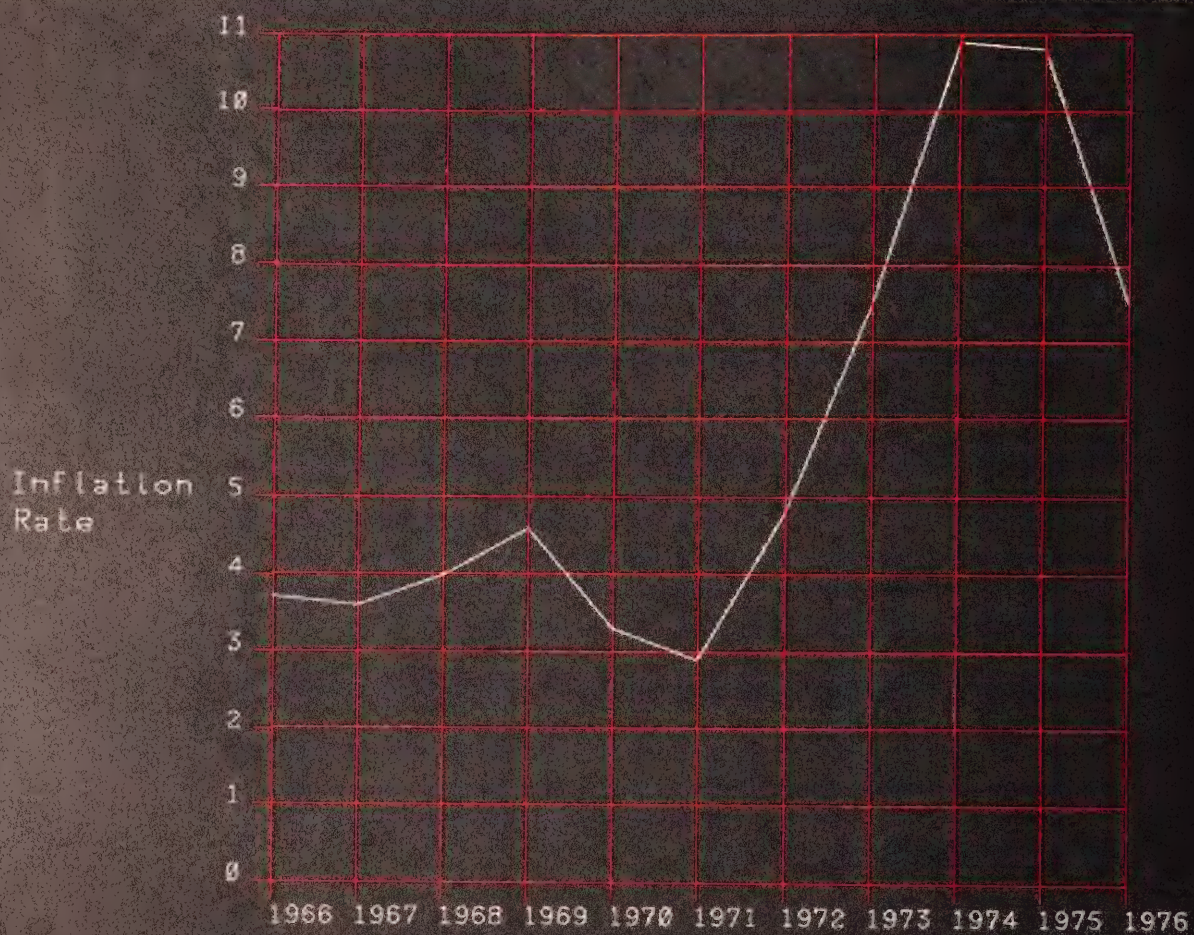
Finding 5

FIGURE 2.M SUMMARIZES THIS PROCESS OF ASSET REVALUATION. / IN THE EARLY 1970'S THE NEW DEMAND FACTORS CAME TOGETHER AT THE SAME TIME AND IMPACTED CUMULATIVELY. PRICES ROSE. THESE INITIAL INCREASES COMBINED WITH ACCELERATING INFLATION TO CHANGE OUR EXPECTATIONS ABOUT FUTURE LAND AND HOUSING PRICES. SINCE PRESENT PRICES ARE PARTLY DETERMINED BY FUTURE EXPECTATIONS, PRESENT PRICES WERE REVALUED SHARPLY UPWARDS. ALL OF OUR EVIDENCE POINTS OVERWHELMINGLY TO DEMAND FACTORS AND CHANGING EXPECTATIONS AS THE PRIMARY FORCES BEHIND THE 1972-1975 LAND AND HOUSING PRICE BOOM.

2. The Real Estate Boom of 1972-1975 with Hindsight

AND WHETHER SOME DEVELOPERS OR MUNICIPALITIES, SOME RATEPAYERS OR PLANNERS, RESTRICTED THE PRODUCTION OF SOME LOTS ON THE URBAN FRINGE WAS CLEARLY OVERWHELMED BY THIS FAR BROADER SHORT-RUN CHANGE. NO FEASIBLE AMOUNT OF NEW SUPPLY ON THE FRINGES OF OUR URBAN AREAS COULD HAVE PREVENTED THE EXTREME INCREASES IN EXISTING HOUSE PRICES, FOR NO FEASIBLE SUPPLY SYSTEM DEVISED BY EITHER MAN OR MIRACLE COULD HAVE SATISFIED OUR GREAT EXPECTATIONS. COMPARED TO THIS OVERWHELMING CONSPIRACY OF CIRCUMSTANCES ON THE DEMAND SIDE, THE POPULAR SUPPLY-SIDE "CONSPIRACY" THEORIES ARE FEEBLE INDEED.

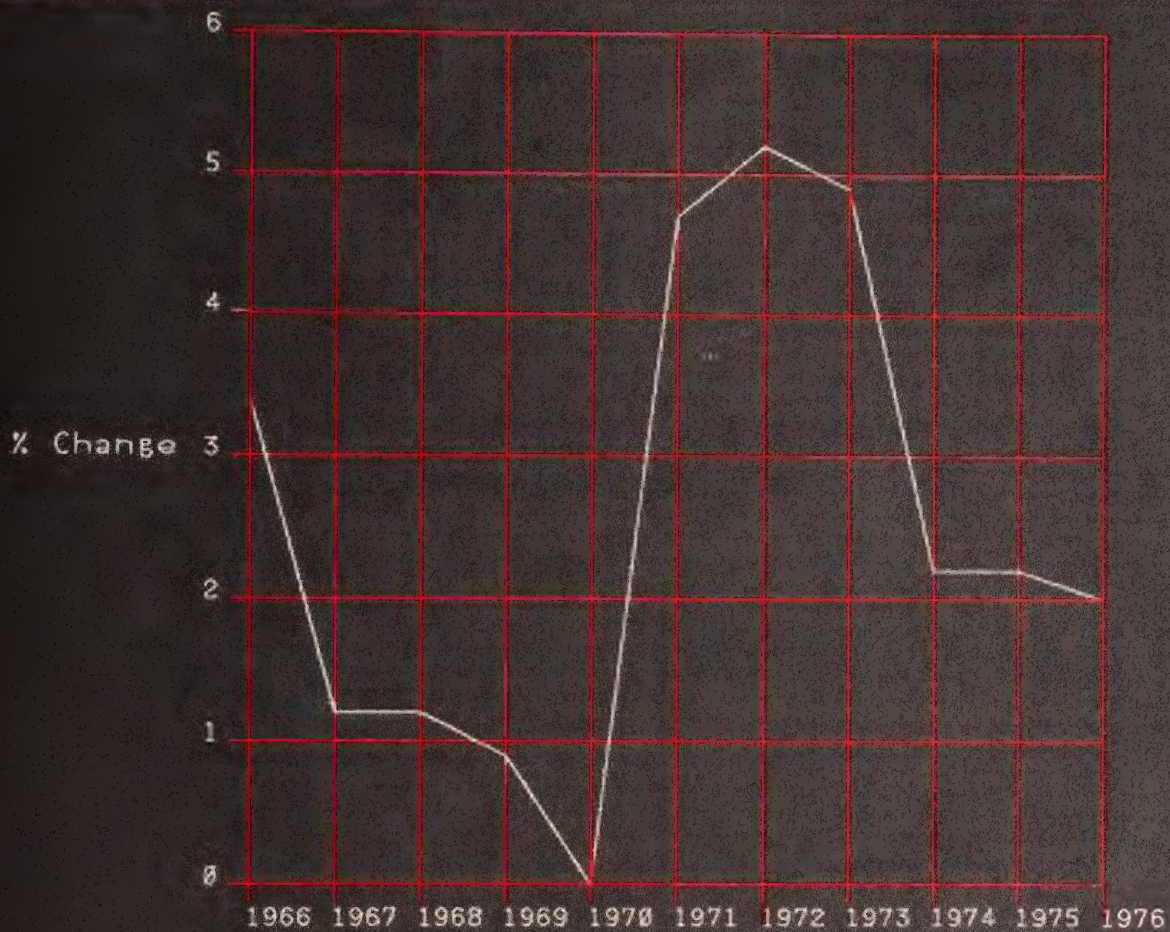
Figure 2.F Inflation Soars



Title: Rates of Inflation, 1966-1976

Source: Table 5.4 of Volume Two

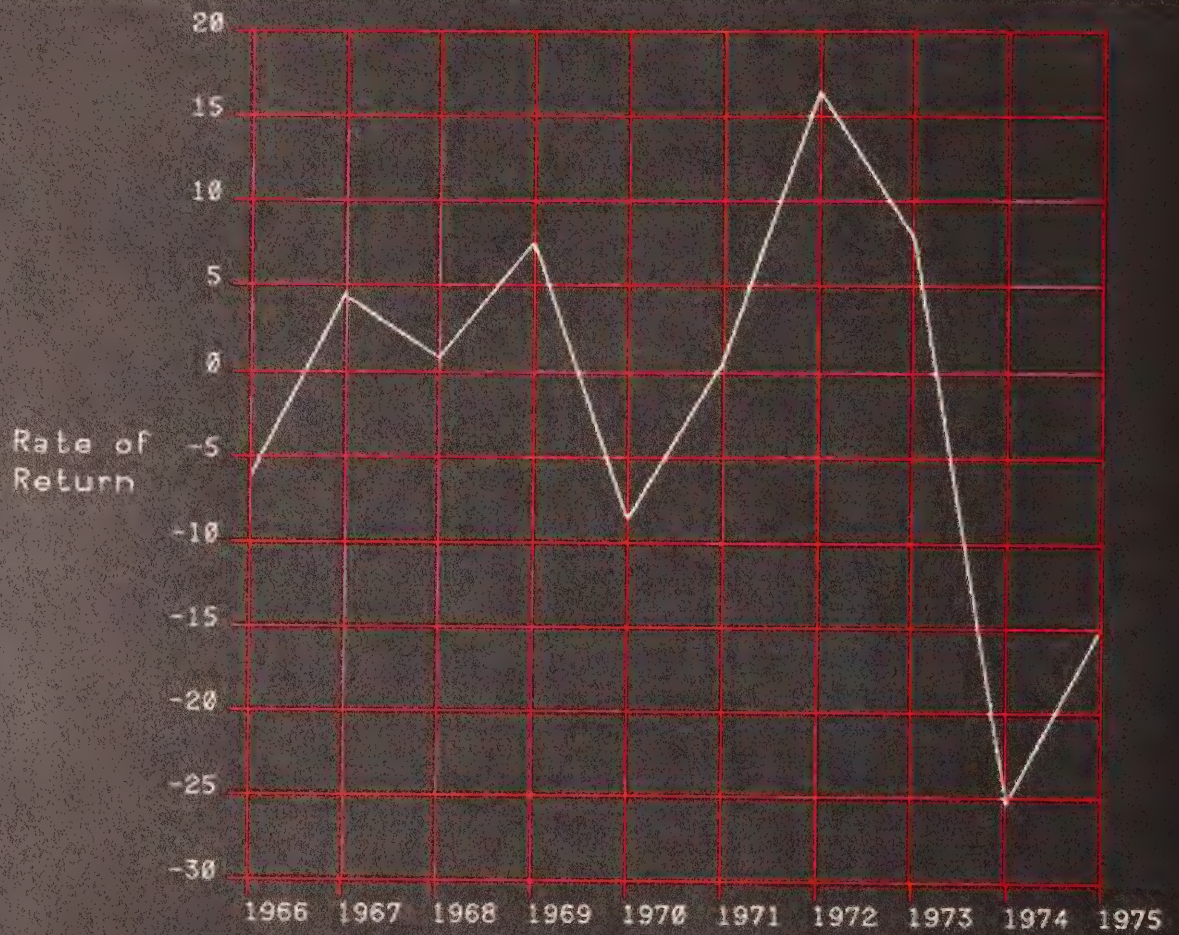
Figure 2.G Incomes Soar



Title: % Change in Real (corrected for inflation)
Disposable Income per Household

Source: Table 5.4 of Volume Two

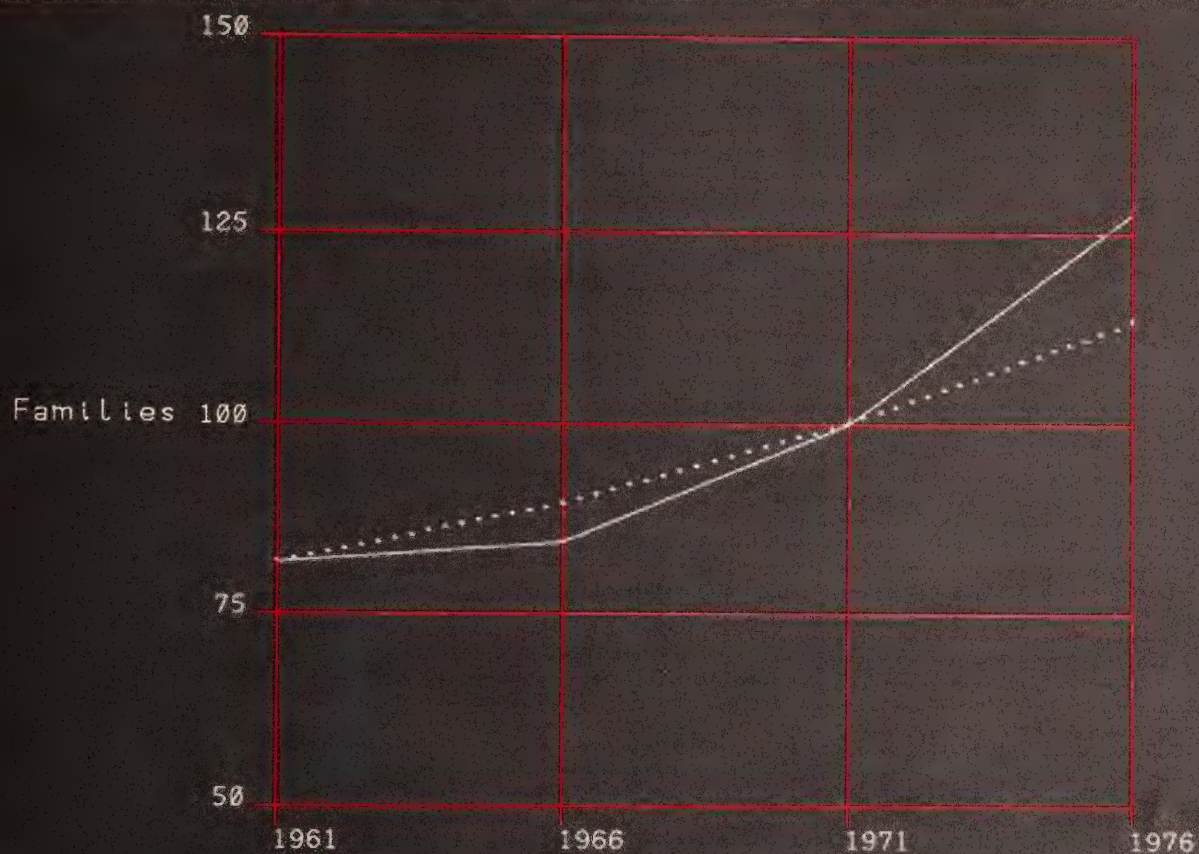
Figure 2.H The Stock Market Plummet



Title: Annual Real Rate of Return on Common Shares
(Toronto Stock Exchange)

Source: Table 5.5 of Volume 2

Figure 2.I Number of Young Families Increases



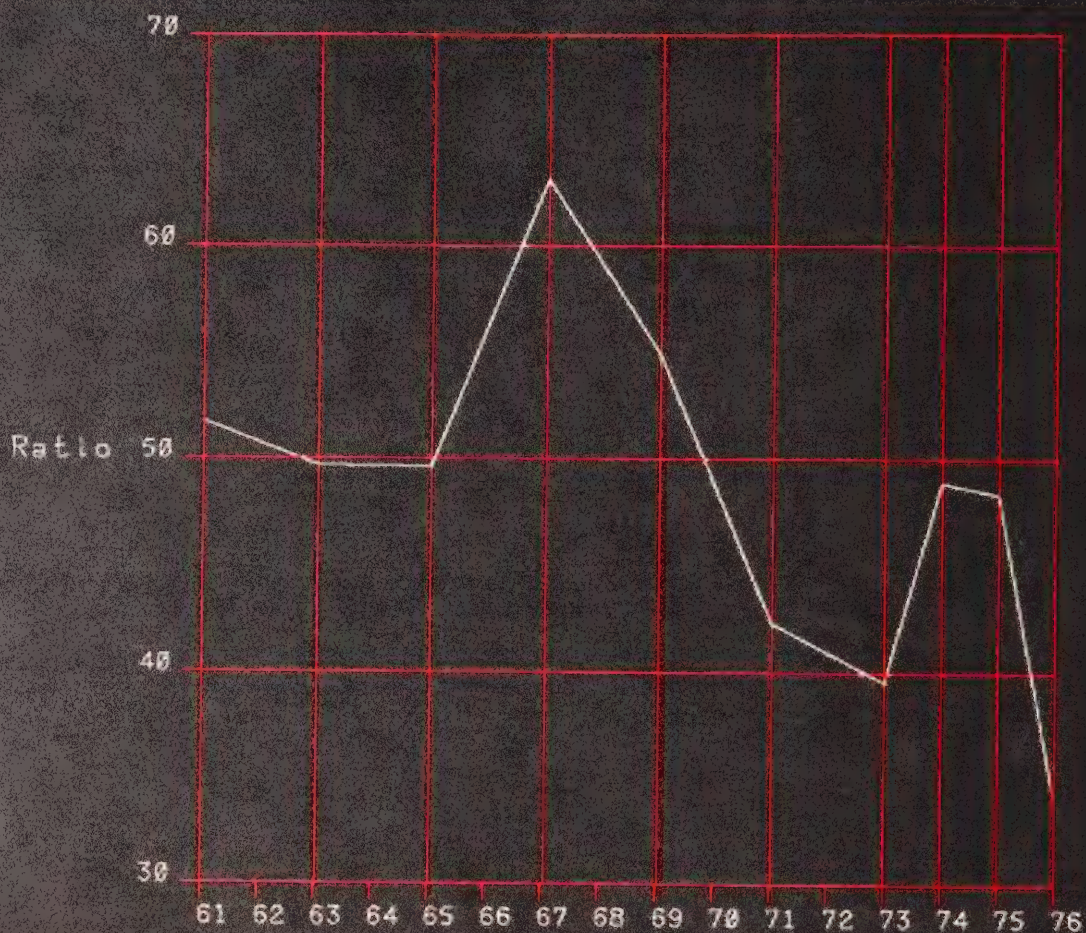
Title: Families by Age of Head (1971=100)

———— Age of Head 25-34

----- All Families

Source: Table 5.1 of Volume Two

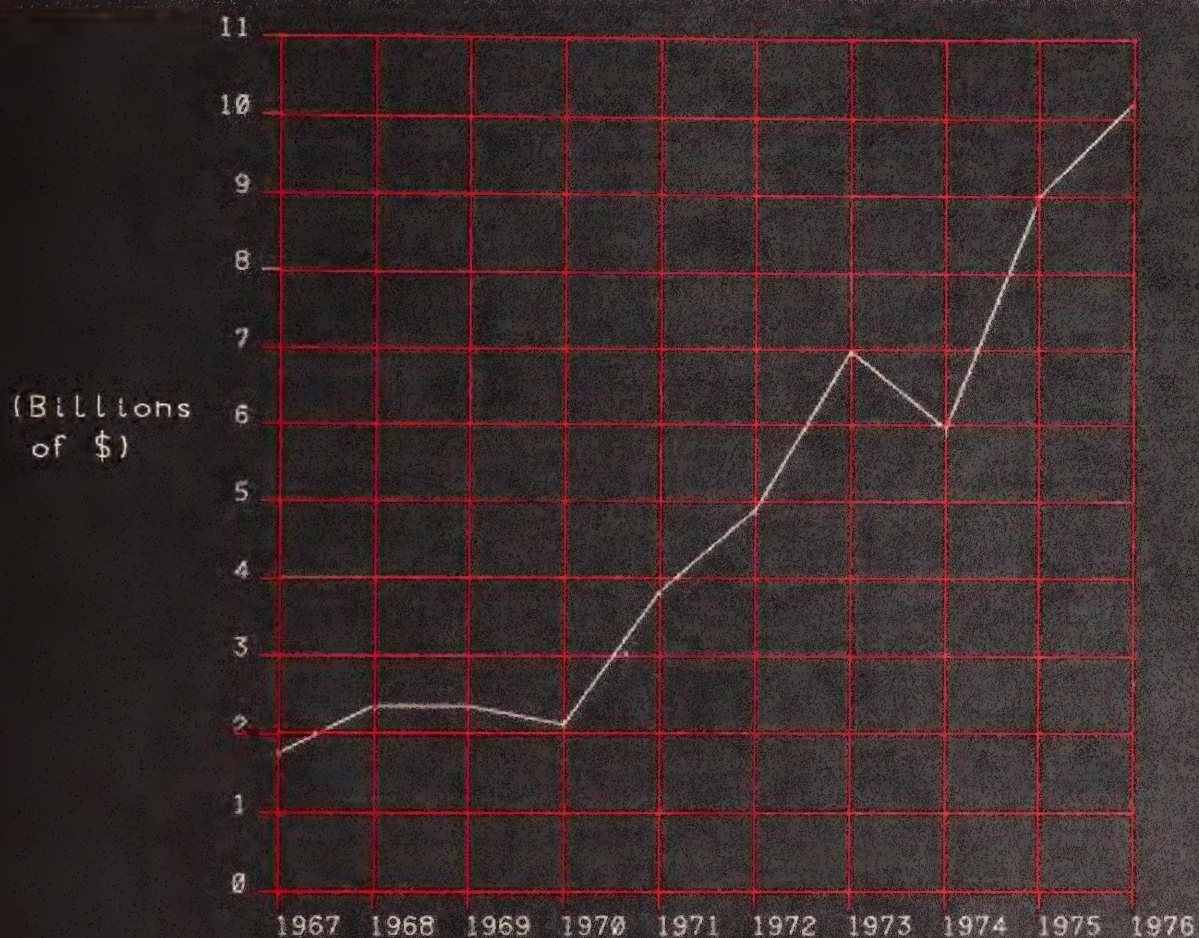
Figure 2.J Amounts of Downpayments Decrease



Title: Ratio of Average Downpayment on National Housing Act Loans to Median Family Income

Source: Table 5.2 of Volume Two

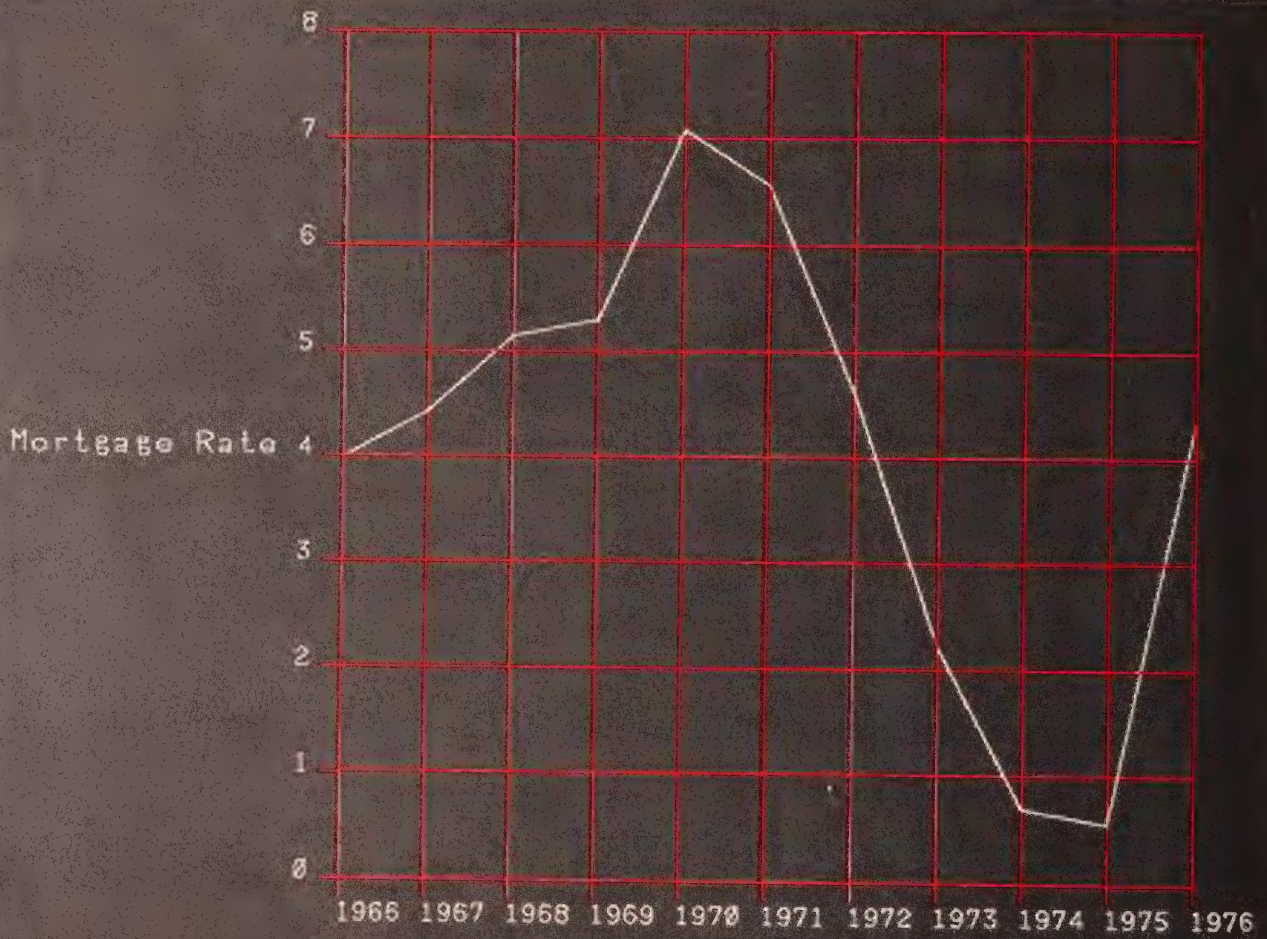
Figure 2.K Volume of Mortgage Money Soars



Title: Volume of Residential Mortgage Approvals (Billions of \$)

Source: CMHC, Canadian Housing Statistics 1976, Table 38

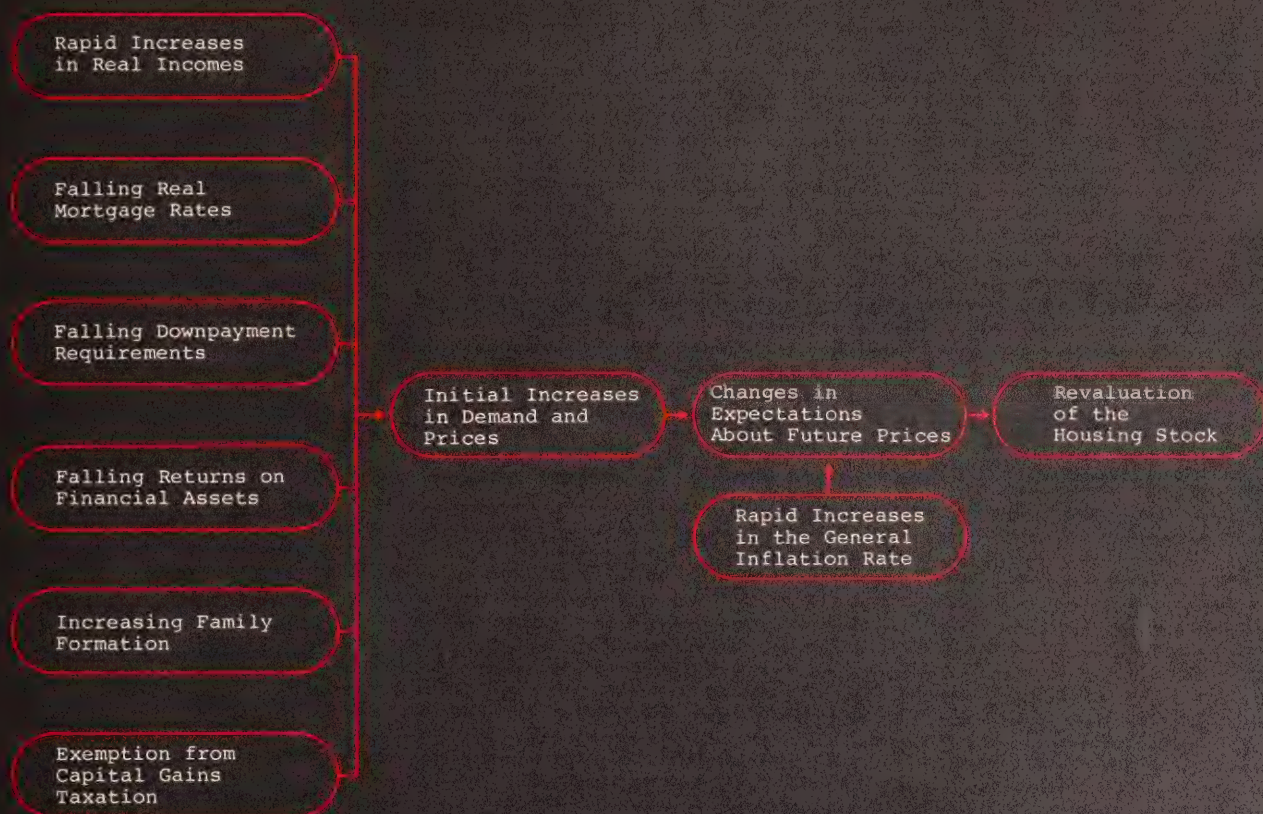
Figure 2.L Real Mortgage Rates Plummet



Title: Conventional Real (corrected for inflation) Mortgage Rate

Source: Table 5.5 of Volume Two

Figure 2.M The Process of Asset Revaluation



3. After The Boom

In The Long Run,
The 5% Tail Does
Wag The 95% Dog

When asset revaluation is not at work, what is?

The mere fact that asset revaluation caused the extreme *increases* of the price boom does not mean that other underlying factors like "monopoly" developers, "selfish" municipalities, government "bureaucrats" or "paranoid" ratepayers did not and will not cause high price *levels*. We have tried to avoid the error of eliminating them as possible causes of high price levels over the long run merely because there is a better explanation for extreme increases in the short run.

Both short-run asset revaluation and long-run underlying factors can and did exist side by side.

For the balance of the Report we concentrate on many of the basic factors which may determine long-run price levels in the future. The reason is that what happened between 1972 and 1975 is now history. Conditions have changed. In most parts of the country, population growth is down. The experts no longer predict exaggerated population growth. Income growth is down; the general economic boom is over. Consequently, expectations about future house values relative to present house prices have declined. Along with the generally sluggish economy, this helps to explain why house prices since 1975 have stabilized or even declined somewhat. This decline may be evidence that a speculative overlay topped off the asset revaluation of the boom and caused prices to overshoot their appropriate levels.

But following this inflationary boom, house prices are likely once again to be determined by the interplay of the traditional housing demand factors and the underlying supply factors of planning restrictions, municipal resistance, servicing costs and the like.

What cannot matter very much in the short run (about a 5% annual increase in dwelling units on the fringes of growing urban areas) matters very much in the long run. The reason is that the 95% of the housing stock which is fixed in the short run is of course a variable in the long run. That is, over years the accumulated new production of about 5% annually determines the size of the fixed stock. Thus, in the long run, the factors which determine the rate of new production in turn determine the size of the overall supply, and the 5% tail does wag the 95% dog.

How then do we explain the fact that even before the boom, land price levels persistently rose?

3. After The Boom

Increasingly, the price of serviced lots has less and less reflected the traditional factors of servicing costs, lost agricultural value and developers' skills.

This important trend is easily explained on the supply side. The long-run supply of land is reduced by planners not concerned with production, municipalities struggling to break even financially, ratepayers resisting more affordable housing and municipal engineers not implementing the new value/effective servicing techniques. This reduction in supply does in turn increase both land and housing prices.

Finding 6 IT IS TRUE THAT COMPARED TO THE DEMAND FACTORS OF THE BOOM, SUPPLY FACTORS USUALLY CHANGE SLOWLY. THEY NEVERTHELESS DO CHANGE. PLANNERS BECOME MORE RESTRICTIVE, MUNICIPALITIES BECOME MORE SENSITIVE TO TAX LOSSES, SERVICING STANDARDS BECOME MORE OBSOLETE AND/OR EXCESSIVE AND RATEPAYERS BECOME MORE AGGRESSIVE. AND IT IS THE CHANGES IN THE LEVELS OF ACTIVITY OF PLANNERS, MUNICIPALITIES, ENGINEERS AND RATEPAYERS (RELATIVE TO CHANGES IN DEMAND) WHICH INCREASE LAND AND HOUSE PRICE LEVELS SLOWLY, BUT STEADILY.

The Long-Term Price Creep

THESE CHANGES CURTAILING NEW PRODUCTION CANNOT CREATE THE INCREASES OF 40% PER YEAR WE SOMETIMES EXPERIENCED IN THE BOOM. BUT WHEN COMPOUNDED OVER TIME THESE SLOW, GRADUAL INCREASES CAN BECOME VERY SIGNIFICANT INDEED. FOR EXAMPLE, IF AN URBAN AREA'S DWELLING UNITS WERE GROWING AT 4% PER YEAR, THE AMOUNT OF HOUSING WOULD MORE THAN DOUBLE IN 20 YEARS. HOWEVER, IF RESTRICTIONS ON SUPPLY REDUCED THE GROWTH OF NEW HOUSING TO ONLY 2% PER YEAR, THE NUMBER OF NEW HOUSES AFTER 20 YEARS WOULD INCREASE BY LESS THAN 50%. THE EFFECT OF THIS RESTRICTIVENESS COULD BE TO INCREASE PRICES OF ALL HOUSES BY AS MUCH AS 30% TO 40% OR MORE OVER WHAT THEY WOULD HAVE BEEN HAD THE 4% GROWTH RATE CONTINUED.

Most of these supply factors are within the control or influence of various governments. That is why we begin our detailed examination of the long-run price determinants by first considering the public sector controversies.

4. Long-Run Price Determinants: Public Sector Controversies

4.1 Planning, Approvals And Municipal Taxes

4.1.1 Planning Versus Production

The Planning Gauntlet -If It Raises Prices, Do We Need It?

Planning raises prices. Usually when a planner draws a line on a map, he restricts some kind of development and reduces the supply of land over a given period of time. So price levels of land which does get approved tend to rise.

This supply restriction causes the market to add an "extra price" to the newly approved land, which is in addition to the scarcity value of all well-located land in or near growing urban areas. This "extra price" is the difference between overall costs including normal profits in producing the land and the selling price. The market adds this "extra price" because approved land is licensed land, and licenses are scarce.

We have measured this "extra price" in a study of a large rezoning in 1961 in the low density neighbourhood of Kerrisdale in Vancouver.(1) Rezoned lots sold for roughly one-third more than before rezoning. Lots nearby which had not been rezoned, and other lots in a control group, actually declined in market price during the same period.

The recent Bellan Report(2) has calculated dramatic "extra prices" in Winnipeg in 1975 of \$33,500 and in 1976 of \$34,000 per acre.

In section 5.2 we will show that there is no evidence that the development industry has the market power to raise lot prices above competitive levels. In many circumstances they are able to pocket this "extra price", but there is no evidence that they cause it.

There is only one other major participant who could create this "extra price" - government. Senior governments after all decide when and where to install major trunk services. Local governments in turn decide when and where to install local services, enact zoning by-laws and official plans, and control in whole or in part the subdivision approval process. If their development licenses were automatic and fast, this "extra price" could not exist. Land prices would always reflect land costs at the edge of development. However, this "extra price" not only exists but persists; there is no evidence that the developers cause it; therefore, in some ultimate way, governments must.

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- (1) Reference: Chapter 10 of Research Studies Volume.
(2) Report and Recommendations of the Winnipeg Land Prices Inquiry Commission, 1977.

4. Long-Run Price Determinants: Public Sector Controversies

Finding 7 HOWEVER, TO ACKNOWLEDGE THAT GOVERNMENT PLANNING RAISES PRICES DOES NOT IMPLY A CRITICISM OF PLANNING. WE DO NOT ACCEPT THE COMMON CHARGE OF DEVELOPERS THAT THE PLANNING PROCESS IS SIMPLY THE PURPOSELESS PURSUIT OF BUREAUCRATIC CONTROL. THERE ARE IMPORTANT REASONS FOR GOVERNMENT TO REGULATE RESIDENTIAL LAND, AND THE COMMON CRITICISM BY DEVELOPERS THAT THE APPROVALS PROCESS IS TOO LONG DISTRACTS US FROM THE FUNDAMENTAL QUESTION: WHY HAVE GOVERNMENTS FOUND IT NECESSARY TO PLAN LAND DEVELOPMENT AT ALL?

Planning: Private Costs
Versus Public Costs And
Environmental Mayhem

GOVERNMENTS PLAN LAND USE BECAUSE THEY KNOW WHAT WILL HAPPEN IF THEY DON'T. THEY KNOW FROM BITTER AND EXPENSIVE EXPERIENCES IN PAST PERIODS OF HIGH GROWTH THAT UNREGULATED PRIVATE DEVELOPMENT CAN LEAVE BEHIND SEVERE PROBLEMS SUCH AS INADEQUATELY TREATED SEWAGE AND THE NEED FOR EXPENSIVE TRANSPORTATION SYSTEMS WHICH CREATE HIDDEN OR DELAYED COSTS AND ENVIRONMENTAL DAMAGE. IF NOT COMPELLED BY THE PLANNING PROCESS, DEVELOPERS AND THEIR CUSTOMERS WOULD NEITHER PAY THESE PUBLIC COSTS NOR AVOID CAUSING THIS DAMAGE.

GOVERNMENT REGULATION IS INDISPENSABLE TO ENCOURAGE PATTERNS OF DEVELOPMENT THAT MINIMIZE SUCH COSTS AND DAMAGE.

If by some miracle private developers and their customers voluntarily assumed the full public costs of development, their projects would also become slower, more integrated, more careful, in a word, more like projects which have been approved after the screening of public planning.

Too Unbelievable To
Believe,
Not Too Unbelievable
To Happen

But it does not necessarily follow that the public planning sieve makes the projects any better. Everyone involved in the process has his favourite horror story about the many slips between this ideal planning purpose and actual planning practice. They are too unbelievable to be believed, but not too unbelievable to have happened. Most of them have the same cause. (By and large (with exceptions like Regina), those who plan care little about production. Often planners do not appreciate, and do not even care to be told, the cost/consequences of their decisions on lot production and lot prices. They tend to regard their planning decisions as *absolute* imperatives rather than as one more benefit which can be purchased only at a *relative* cost in terms of another thing of value, cheaper lot prices. If we think developers left alone would produce and not plan, we fear planners left alone would only plan and not produce.)

4. Long-Run Price Determinants: Public Sector Controversies

One piece of evidence for this is that most municipal planners across Canada have a shocking lack of data on the availability of land at various stages of production organized in a form in which price-related questions can be asked.

It is one thing to force developers and their customers to pay a fairer share of social costs. It is another thing to restrict production and increase price levels so much that many customers are priced out of the market.

Finding 8 { EARLIER WE DISMISSED THE POSSIBILITY THAT EXCESSIVE PLANNING RESTRICTIONS COULD HAVE BEEN RESPONSIBLE FOR THE RAPID PRICE INCREASES OF THE SHORT BOOM. BUT OVER LONGER PERIODS, TO LOWER THE PRICE OF SERVICED LOTS PERMANENTLY IN THE FACE OF STRONG DEMAND, IT WILL BE NECESSARY FOR MUNICIPALITIES AND PLANNERS PERMANENTLY TO INCREASE THE NUMBER OF LOTS THEY PERMIT TO BE PRODUCED. IN OTHER WORDS, IT IS NECESSARY THAT THE PROCESS BECOME LESS RESTRICTIVE.

{ MUNICIPALITIES AND PLANNERS OUGHT TO BE RESPONSIBLE NOT MERELY FOR MAINTAINING SERVICING AND PLANNING STANDARDS, BUT ALSO FOR NOT INHIBITING THE PRODUCTION OF QUANTITY RELATIVE TO NEED.

ONE CAN ONLY HOPE, CAUTIOUSLY, THAT THEY WILL RISE TO THE CHALLENGE OF BALANCING ADEQUATE PLANNING WITH ADEQUATE PRODUCTION.

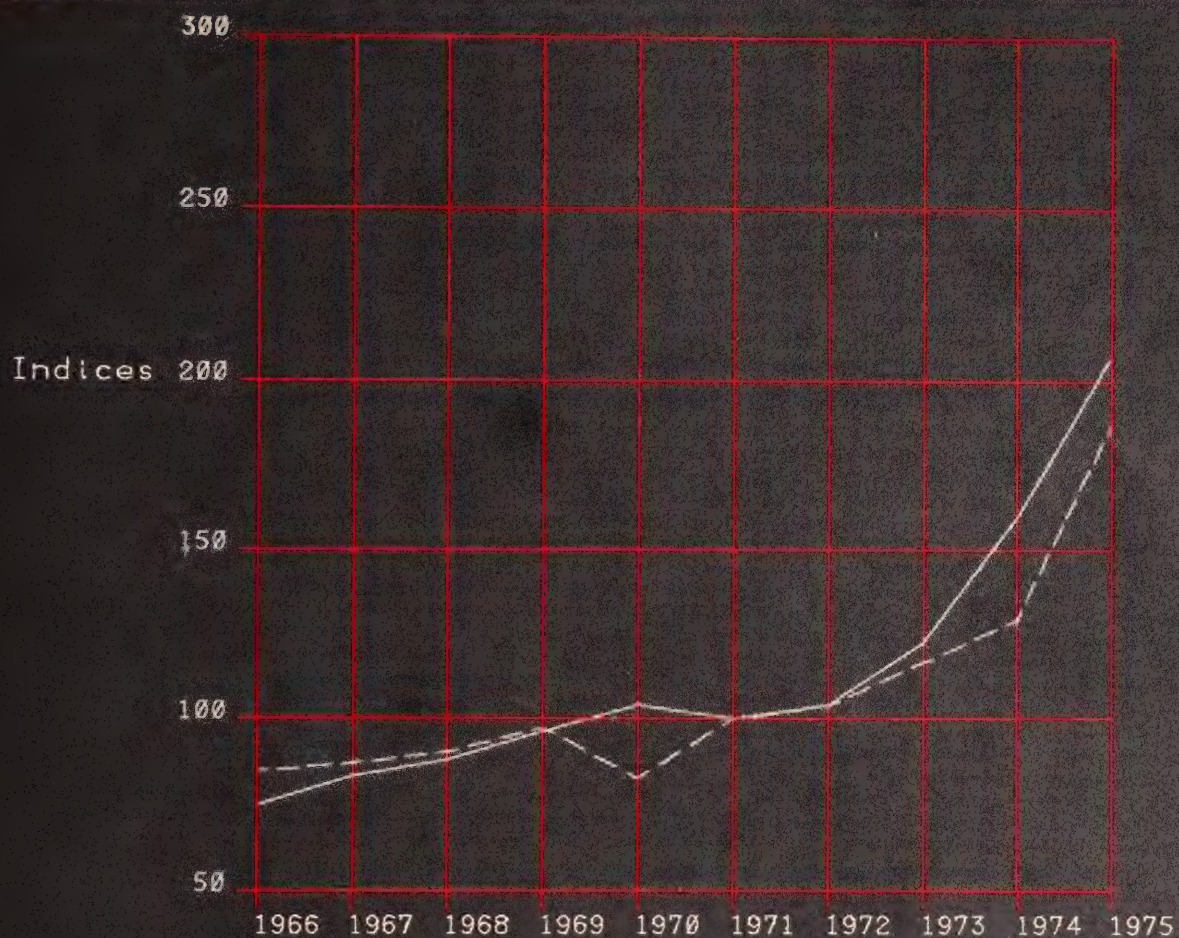
**What Provincial And
Municipal Governments
Can Do: Winnipeg
Versus Regina**

Under the pressures of the boom, Regina demonstrated that such a balance can be achieved temporarily. Its official attempt to maintain an adequate supply of approved lots clearly delayed and moderated lot price increases. Of six major cities studied west of the Ottawa River, (1) only Regina was able to keep its rate of lot price increases below its rate of house price increases for the entire period from 1972 to 1975. Figure 4.A shows this relationship for Regina between lot prices and dwelling prices from 1966 to 1975.

In Figure 4.B Winnipeg demonstrates the other extreme. It was the only city of the six studied in which the rate of lot price increases moved above the rate of house price increases in 1972 and stayed above it for the entire boom period. We believe the explanation results from the combined activities of the governments of Manitoba and of Winnipeg. In 1972 the government of Manitoba combined the municipalities in the Winnipeg area into a single, large "Unicity". This virtually

(1) Reference: Chapter 10, Volume Two

Figure 4.A Regina: Lot Prices Versus House Prices



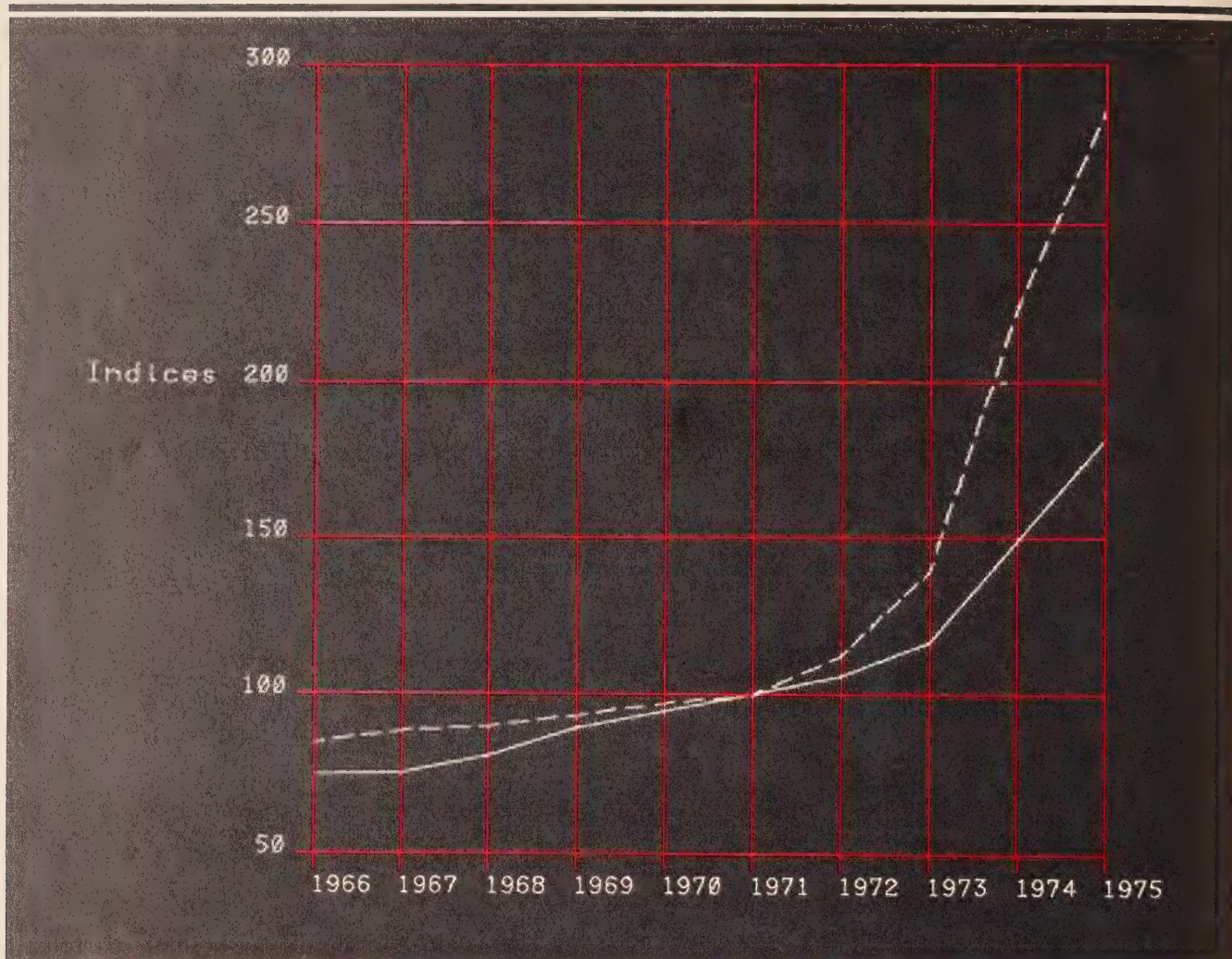
Title: Indices of Lot and Dwelling Prices (Regina). 1971=100

----- Lot Prices

_____ MLS Dwelling Prices

Source: Chapter 2 and Appendix 1 of Volume Two

Figure 4.B Winnipeg: Lot Prices Versus House Prices



Title: Indices of Lot and Dwelling Prices (Winnipeg). 1971=100
----- Lot Prices
_____ MLS Dwelling Prices

Source: Chapter 2 and Appendix 1 of Volume Two

4. Long-Run Price Determinants: Public Sector Controversies

stopped subdivision approvals in that year. At the same time, Winnipeg itself imposed higher servicing standards and new policies against sprawl. Thus, right at the beginning of the inflationary period the two governments combined to tighten up supply. This virtually guaranteed that lot price increases would immediately reflect the boom.

Other Cities Toronto, Vancouver, Calgary and Edmonton were found to be the in-between areas, where lot prices lagged behind house prices for at least one of the years after 1971.

Calgary and Edmonton imposed new planning policies which led to approval delays; this put more pressure on the existing supply of approved lots; lot price increases followed and then passed house price increases with only a small lag.

In Toronto, house prices exploded in 1973, lot prices in 1974. But 1974 was the year in which Ontario conferred an especially low number of subdivision approvals (411) relative to the number of subdivision applications in that year (1223).(1) Was this in part because three new regional governments were initiated in that year? For the greater Toronto area, Ontario in 1974 approved only four-fifths of the lots it approved in 1973, and a further reduction took place in the first half of 1975.(2) It is difficult to avoid the conclusion that the low number of approvals in 1974 helped fuel the lot price boom of that year.

4.1.2 Length Versus Restrictiveness It cannot be stated too often. Developers can produce no more than the public planning process permits.

~~This~~ This is because each basic pre-condition for bringing land to market is decided by local and provincial governments: regional plans (where required), official plans (where required), zoning, local services, subdivision approval, and most basic of all, the provision of the trunk sewers. As a result, apart from making atomic bombs, the development business must be one of the most tightly restricted businesses there is. (This is not to deny that developers often successfully overcome the restrictions).

(1) Reference: Chapter 10, Volume Two

(2) Muller, R.A: The Market for New Housing in The Metropolitan Toronto Area. Ontario Economic Council, 1978.

4. Long-Run Price Determinants: Public Sector Controversies

Nevertheless, Regina showed that the public planning process can approve lots quickly, and that quickly cranking up the supply of approved lots delays and moderates lot price increases over short periods.

But, as stated in Finding 7, to lower the price of subdivision land permanently in the face of strong demand, it is necessary permanently to increase the rate at which lots are approved. In other words, it is necessary that the process become less restrictive.

Restrictiveness Is Expensive

Merely tinkering with the *length* of the process over the long run will not be sufficient to lower the price of subdivision land permanently in the face of strong demand. Length is not the problem; restrictiveness is. If your bus route to work becomes longer, you adjust each morning by leaving earlier. Similarly, the development industry can adjust (within limits) to changes in the length of the process. But if your bus breaks down half the time, the total number of times you get to work becomes permanently less. Similarly, for any given level of demand, if the number of lots delivered by the approval process permanently decreases, prices must rise.

However, where approval processes were unexpectedly lengthened during the boom, the net effect was restrictiveness - fewer lots reached the market during that period.

Finding 9

LEGITIMATE CONCERNS OVER ENVIRONMENTAL ISSUES, SERVICING STANDARDS, DEVELOPMENT PATTERNS AND DENSITIES HAVE LED TO RESTRICTIONS WHICH UNDERLAY THE LOT SUPPLY SHORTAGE DURING THE BOOM. THEY MAY IN FUTURE LEAD TO MORE RESTRICTIONS, AND WE FEAR THAT THE FULL IMPACT ON LAND PRICES OF THESE INCREASING RESTRICTIONS BY PROVINCES, MUNICIPALITIES AND PLANNERS HAS YET TO BE FULLY REALIZED.

4.1.3 Taxes Versus Homes

Municipal leaders persistently claim that certain kinds of new residential growth are too costly and that is why municipalities cannot accept responsibility for not inhibiting the production of quantity relative to need.

Although they combine to produce the same result, such municipal resistance to production on fiscal grounds is different from the planners' resistance to production on planning and environmental grounds.

4. Long-Run Price Determinants: Public Sector Controversies

Why The Municipalities Resist Cheaper Land - Money, Not Principle

Many municipalities do not, on fiscal grounds, restrict all growth. They do, however, try to restrict unprofitable growth. Their opposition is a matter of revenues, not of principle.

One reason is the biased structure of the property tax. Properties are both the main source of municipal revenues and the main cause of municipal costs. All municipal costs are for services to the people who either work or live in properties. Municipalities in the long run want to break even. They must in the long run get enough revenues from properties to pay all the costs they cause (less revenues from other sources).

Winners And Losers

Based on the existing tax system, new business and industrial properties usually create far more revenues than costs.⁽¹⁾ But new residential properties other than small apartments and big houses usually create far more costs than revenues.⁷ The reason is that residences are undertaxed while factories and businesses are overtaxed relative to their respective needs for public services like schools, police protection and welfare payments. For municipal revenues, factories and businesses are winners, often big winners. Most residences are losers.

In cities which have balanced growth of both factories/businesses and residences, or where regional government permits some pooling of tax revenues, the profits from the business winners may offset the losses from the residential losers. But many municipalities are not in regional government and have unbalanced growth; typically, bedroom suburbs bordering large central cities attract much more unprofitable residential assessment than profitable factory/business assessment.

The municipal property tax system therefore gives them no incentive to make cheap housing available. Indeed, the reverse is true. The tax system gives them every incentive to make it unavailable. They have no more incentive to provide cheap housing for non-existent homeowners than the government of British Columbia has to provide services for the people of the state of Washington.

Ratepayers And Rate-setters

The next logical question then becomes, why don't municipalities just raise taxes to cover these losses? The reason is that the ratepayers are also

(1) Reference: Chapter 11, Volume Two

4. Long-Run Price Determinants: Public Sector Controversies

the rate-setters, and are unlikely to increase their own tax burden if they can avoid it.

We wish to emphasize one basic wrinkle. In a municipality where *new* townhouses are losers, *existing* townhouses may be or may once have been losers too. Where a certain dwelling type is unprofitable, both new and old residences having the same characteristics may be unprofitable. This enables us to understand the reaction of municipal councils; they have experienced housing which doesn't pay its own way and they don't want any more.

Doing What Comes Naturally

Councils represent existing, not potential property owners. Quite apart from unprofitable residential growth, their costs have been rising steadily and unavoidably because of general inflation, increasing public demands for more services and the pressures of public service unions. Under the stress of these rising costs, councils understandably become obsessed with maintaining mill rates, for any tax increase falls on existing voters. But increases caused by unprofitable growth for new residents are avoidable. Municipal representatives do, inevitably, what comes naturally. They protect their existing voters by keeping out, limiting or slowing down the influx of new residents who can't afford the bigger, more profitable houses. Their strategy: assessment planning. Their tool: the approval process.

How The Municipalities Resist Cheaper Land - The Approval Process

They use various techniques which are embedded in the approval process. They may accept some residential growth, but make it pay its own way. They may force the developer to pay special levies or lump-sum payments per lot supposedly approximating the present value of the future losses each lot will generate. Through their servicing and zoning powers, they may limit or slow down the total amount of residential development. Through zoning and other restrictions which increase lot sizes and reduce densities they may emphasize profitable growth like small apartments and big houses and may limit or slow down unprofitable growth like townhouses.

Political, Not Technical

The approval process in part is merely clever camouflage for assessment planning. It is not an objective, rigid process which impersonally and impartially evaluates applications equally. Rather, it is basically a political process in which applications which are perceived to be profitable experience minimal difficulty and those which are perceived to be unprofitable like moderate income housing frequently experience maximum difficulty.

4. Long-Run Price Determinants: Public Sector Controversies

The planning process is often the technical means elected representatives use to implement their assessment strategy.

All Power Is Delightful;
Absolute Power Is
Absolutely Delightful

Municipalities write by-laws to control the development process. Therefore developers can rarely produce exactly what they think the market wants without first going to the municipality for approval. In seeking that approval, a developer exposes himself to the municipality's demands; the whole process is one of bargaining over those demands. Furthermore, the municipality has no incentive to respond to the financial needs of either the developer or his potential homebuyers.

To Get Along, Go Along

In these circumstances developers who want to do business over the long term are generally guided by the prudent rule: to get along, go along.

Of course much of the bargaining is between the professionals on both sides. The uninitiated watching those formula-spouting professionals wrangling about such apparent certainties as population conversion ratios, gross floor space indices and the like, may be forgiven for concluding that planning is professional, legal and technical. They confuse the technical means by which planning is carried on with the economic and political purposes of planning.

But no successful developer ever mistakes the camouflage for the reality.

The cost concerns of many municipal politicians coincided with the rise to prominence of the environmentalists and of citizen advocates of less growth. Elected representatives resisted moderate income housing to protect the existing tax base and to stay elected; citizen groups resisted on quality-of-life principles and to preserve their equity in their own houses. Together in many municipalities they formed a natural (their critics call it unholy) alliance to resist cheaper housing and smaller lots.

The Poor But Agile
Versus The Rich
But Clumsy

During the price boom, Ottawa and some provinces became desperate to encourage more affordable housing. They tried to persuade the municipalities to accept this social goal by the carrot of various funding programs, but not much stick.

Poor but agile municipalities could outmanoeuvre the rich but clumsy senior governments. Municipalities, after all, controlled the narrow spout of zoning and local servicing through which the schemes of Ottawa and some provinces had to be

4. Long-Run Price Determinants: Public Sector Controversies

funnelled. Until individual municipalities could be shown that senior government programs significantly corrected tax deficient development, they resisted strenuously and effectively. The municipalities usually won.

It is beyond our mandate to second-guess provincial governments on reforming or replacing the property tax and on creating unitary or regional governments out of fragmented municipalities. Clearly these involve important policy considerations far beyond land prices.

Finding 10 THE BASIC PROBLEMS REMAIN - BOUNDARY FRAGMENTATION AND THE BIASED STRUCTURE OF THE PROPERTY TAX. ONE INEVITABLE COST/CONSEQUENCE IS DETERMINED RESISTANCE TO CHEAPER HOUSING BY MANY MUNICIPALITIES. TO PREDICT THEIR CONTINUING RESISTANCE IS NOT TO CONFUSE THE FAMILIAR WITH THE NECESSARY. MUNICIPALITIES WILL CONTINUE TO RESIST CHEAPER HOUSING IF THEIR TAX DEFICIENCIES CONTINUE UNCORRECTED.)

Who Are The Real Monopolists? THEIR RESISTANCE IS EFFECTIVE BECAUSE MONOPOLISTS DO CONTROL MANY SUBURBAN LAND MARKETS. HOWEVER, THE MONOPOLISTS ARE NOT DEVELOPERS CONTROLLING OUTPUT TO PROTECT THEIR SHAREHOLDERS BUT MUNICIPALITIES RESTRICTING OR HIGHGRADING GROWTH TO PROTECT THEIR TAXPAYERS. WHERE ONLY A FEW SUBURBAN MUNICIPALITIES CLUSTER AROUND A CORE AREA, EACH MAY EXERCISE ENOUGH INDEPENDENT MARKET POWER TO RESTRICT TAX-DEFICIENT HOUSING.)

A Solution: Attack Municipal Deficits, Not Municipal Virtue SENIOR GOVERNMENTS ARE ALREADY MOVING TOWARDS A SOLUTION - PARTIALLY COMPENSATING MUNICIPALITIES FOR LOSSES ON UNPROFITABLE HOUSING. THE FUNDS, MOSTLY FEDERAL, USED TO PAY FOR THE LARGE PROVINCIAL LAND BANKS WHICH HAD NO DISCERNIBLE IMPACT ON HOUSE PRICES DURING THE BOOM, COULD HAVE BEEN SPENT MORE EFFECTIVELY THIS WAY. SINCE THE BASIC PROBLEM IS ONLY ONE OF REVENUES AND NOT OF PRINCIPLE, THE SOLUTION IS SIMPLY TO ATTACK MUNICIPAL DEFICITS, NOT MUNICIPAL VIRTUE.

UNTIL THE SENIOR GOVERNMENTS DO WHAT THEY CAN, THE MUNICIPALITIES WILL DO WHAT THEY MUST.)

4.1.4 Planning Versus Economic Reality Earlier we stated that the fundamental question is not the length of the planning process but rather, why regulate land use at all? After all, there is plenty of land to build on; for example, the greater Metro Toronto area has almost 700,000 acres of vacant land which could theoretically take another 9,000,000 people.(1)

(1) Op. cit. p. 38

4. Long-Run Price Determinants: Public Sector Controversies

Many planners answer this question by pointing to growing concerns about environmental issues, servicing standards, development patterns and densities. Many municipalities answer this question by pointing to their tax losses on many types of housing. In responding to these concerns they have created two types of increasing restrictiveness. One prohibits all residential development; greenbelts are an example. The second type permits some residential development, but limits its density. Pervasive examples are the many by-laws limiting large suburban areas to 50-foot lots.

Finding 11

Economic Reality Versus Legislative Wand-Waving

ONE FACT IS CENTRAL TO THE SECOND TYPE OF RESTRICTIVENESS: GOVERNMENTS CAN PREVENT DEVELOPMENT THEY DON'T WANT, BUT CANNOT BY LEGISLATIVE WAND-WAVING ORDER INTO EXISTENCE DEVELOPMENT THEY DO WANT. GOVERNMENTS MAY ESTABLISH BROAD DEVELOPMENT CONCEPTS AND PROVIDE MAINLINE SEWAGE, STORM, TRANSPORTATION AND WATER FACILITIES, BUT ONLY ECONOMIC REALITY DECIDES THE TYPE AND TIMING OF DEVELOPMENT.

EVEN IN TORONTO'S COMMERCIAL CORE IN 1976, ONLY ABOUT 10% OF ALL COMMERCIAL PROPERTIES HAD THE MAXIMUM ALLOWABLE FLOOR AREA. BECAUSE OF ECONOMIC REALITIES, PRIVATE AND PUBLIC DEVELOPERS MAY NOT WANT TO DEVELOP APPROVED LAND IMMEDIATELY, OR TO SEEK APPROVAL IN DESIGNATED, "CONTIGUOUS" AREAS, OR TO BUILD THOSE BIG HOUSES WHICH WOULD BE PROFITABLE TO THE MUNICIPALITY IF ONLY ENOUGH CONSUMERS COULD AFFORD THEM.

Shortages In The Midst Of Plenty

IN SPITE OF THE BEST GOVERNMENT INTENTIONS, THE PARADOX OF LAND SHORTAGES IN THE MIDST OF PLENTY COULD BECOME A REALITY BECAUSE PRIVATE AND PUBLIC DEVELOPERS WILL NOT NECESSARILY DEVELOP IN THE PLACES, AT THE TIMES, FOR THE USES AND AT THE DENSITIES DESIGNATED BY GOVERNMENTS.

4.2 Servicing, Lot Levies And Federal Taxes

4.2.1 The Relationship Between Servicing Costs And Lot Prices

Our information on servicing costs has both breadth and depth. We have been able to obtain detailed analyses of servicing costs for specific development projects both private and public in 21 municipalities across the country. We have also obtained detailed analyses of servicing standards for 43 municipalities.

The evidence is fairly consistent across the country. Increases in servicing costs were major contributors to lot price increases until the early 1970's. During the boom, however, lot prices took off, leaving servicing costs behind.

To illustrate this point, in Figure 4.C we chose Scarborough because our research shows that its servicing costs increased extremely fast during the

4. Long-Run Price Determinants: Public Sector Controversies

boom.(1) Here, up to 1973, the price of serviced lots and servicing costs moved very closely together. In 1973, however, lot prices exploded, leaving servicing costs far behind. Similar patterns occurred almost everywhere; indeed, the difference between lot price increases and servicing cost increases are often even larger than in Scarborough.

Finding 12

Servicing Costs: Irrelevant
To The Boom, But
Important For The Future

WE CONSTRUCTED FIGURE 4.C WITH THE DELIBERATE INTENT OF PROVING THE COMMON CLAIM THAT INCREASING SERVICING COSTS WERE A LARGE CONTRIBUTOR TO THE PRICE BOOM OF 1972-1975. BUT THE DATA REJECT THIS CLAIM AS LOT PRICES DRAMATICALLY OUTSTRIPPED SERVICING COSTS. WE THEREFORE FIND THAT SERVICING COSTS WERE NOT A MAJOR CONTRIBUTOR TO THE BOOM. THIS FINDING IS CONSISTENT WITH OUR EARLIER ARGUMENT THAT FACTORS AFFECTING THE PRODUCTION OF NEW HOUSING WERE NOT PRIMARILY RESPONSIBLE FOR THE BOOM. NOW THAT THE PRICE BOOM HAS ENDED, SERVICING COSTS WILL AGAIN BECOME A MAJOR DETERMINANT OF LOT PRICES; OUR RESEARCH HAS SHOWN THAT HARD SERVICING COSTS AND NOT RAW LAND COSTS ARE GENERALLY THE MAJOR COST IN PRODUCING SERVICED LOTS.

4.2.2 The Relationship Between Municipal Servicing Standards And Servicing Costs

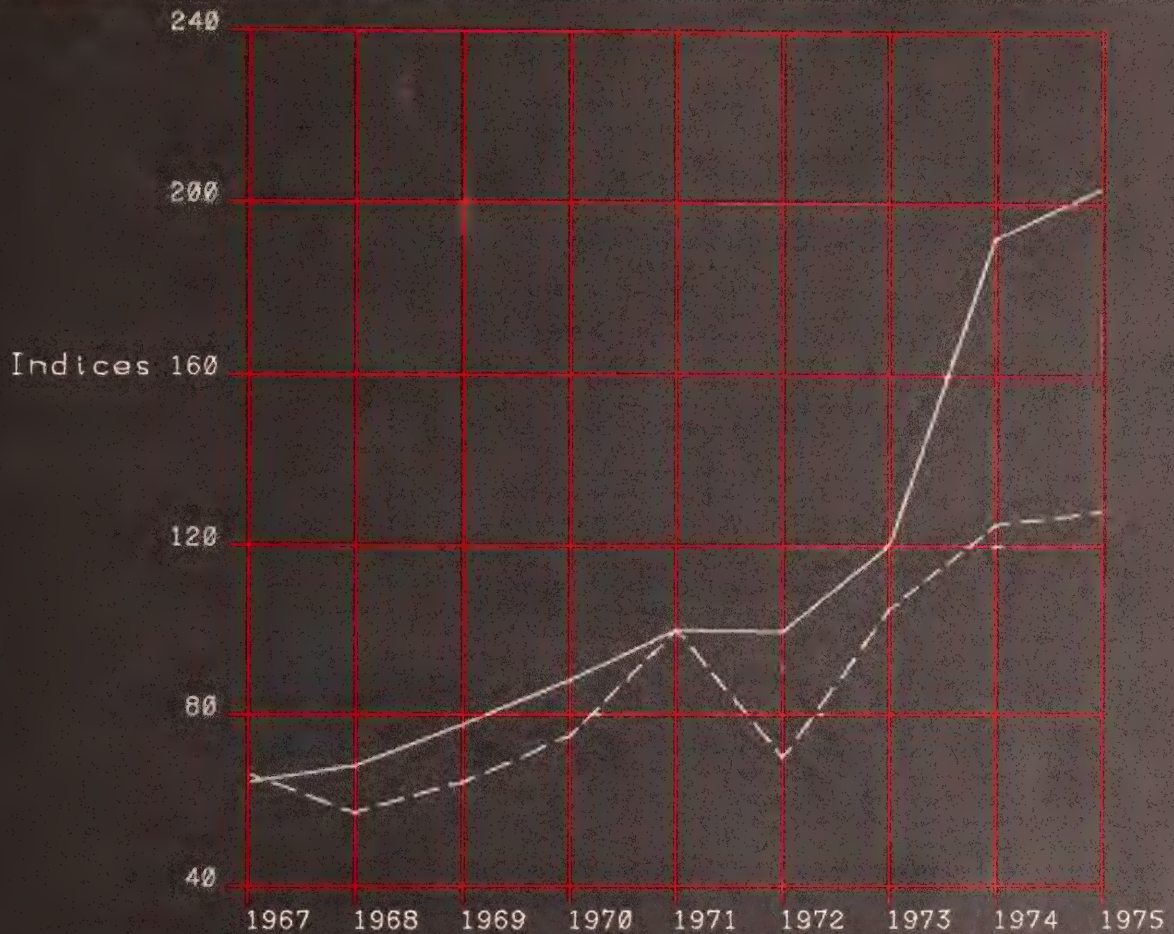
Servicing costs are significantly affected by the servicing standards imposed by individual municipalities. Standards vary astonishingly even within metropolitan regions where climate, soil, topography, labour costs and material costs are essentially the same.(2) Comparing the City of Brampton and the Borough of Scarborough illustrates this variation. Brampton is a growth municipality just outside Metropolitan Toronto. Scarborough is a suburban borough in Metropolitan Toronto. They share similar climate, soil, topography, labour costs and material costs.

Before we did our detailed analysis we held the conventional opinion that high standards meant high costs, and that high costs implied effective standards. We therefore chose for detailed analysis of servicing standards a municipality with high costs, Scarborough, and a municipality with low costs, Brampton. Our results were the opposite of our expectations. Brampton's low cost services were far more value/effective than Scarborough's high cost services. For example, in storm drainage Scarborough's standards are far more expensive. Its average cost per lot is \$2,367; Brampton's is only \$708. But they are also

(1) Reference: Chapter 8, Volume Two

(2) Reference: Ibid

Figure 4.C Lot Prices Soar Beyond Servicing Costs During The Boom



Title: Lot Price and Servicing Cost Indices (1971=100)
 — Lot Price -- Toronto
 ---- Servicing Cost Index -- Scarborough

Source: Chapter 8 and Appendix 1 of Volume Two

4. Long-Run Price Determinants: Public Sector Controversies

less effective; many Scarborough basements have experienced serious and repeated flooding.

Finding 13 BRAMPTON ADOPTED NEW VALUE/EFFECTIVE TECHNIQUES. (1) FIGURE 4.D SHOWS THE DRAMATIC RESULT. IN 1976 BRAMPTON'S SERVICING COSTS IN CERTAIN AREAS WERE UP TO \$4,600 PER LOT LESS THAN SCARBOROUGH'S. BECAUSE SCARBOROUGH HAS IMPOSED EXTREMELY EXPENSIVE STANDARDS, SAVINGS OF \$4,600 PER LOT MAY BE HIGHER THAN NORMAL. BUT OUR JUDGMENT IS THAT IF MUNICIPALITIES ACROSS THE COUNTRY REPLACED THEIR EXCESSIVE AND/OR OBSOLETE STANDARDS WITH THE NEW VALUE/EFFECTIVE TECHNIQUES THE TOTAL SAVINGS COULD BE IMMENSE. UNDER THE MARKET CONDITIONS WHICH IN OTHER SECTIONS OF THIS REPORT WE CONCLUDE ARE LIKELY TO PREVAIL IN THE NEAR FUTURE, SOME OF THESE SAVINGS SHOULD BE PASSED ON TO HOME BUYERS.

**Servicing Cost Increases
Can Be Controlled**

However we cannot be optimistic that the municipalities will make the necessary changes. As long as senior levels of government continue to permit the "anarchy" of each municipality setting its own standards, it is difficult to foresee a consistent pattern of improvement. For example, the Ontario government has recommended to its municipalities detailed value/effective servicing standards, but has carefully refrained from imposing them.

Finding 14 THE DIFFICULTY IS THAT SERVICING STANDARDS ARE A TRADITIONAL MUNICIPAL RESPONSIBILITY AND PROVINCIAL GOVERNMENTS ARE EXTREMELY RELUCTANT TO COMPEL CHANGES THEY CANNOT ACHIEVE BY PERSUASION. PERHAPS ON THIS ISSUE THE TRADITIONAL REASONS FOR NOT INTERFERING, NO MATTER HOW GOOD, OUGHT TO GIVE WAY TO BETTER. ONE SOLUTION WHICH PROVINCIAL GOVERNMENTS COULD CONSIDER WOULD BE TO IMPOSE ON THEIR MUNICIPALITIES VALUE/EFFECTIVE STANDARDS AS UPPER LIMITS BEYOND WHICH THE MUNICIPALITIES COULD NOT DEMAND ANYTHING FURTHER.

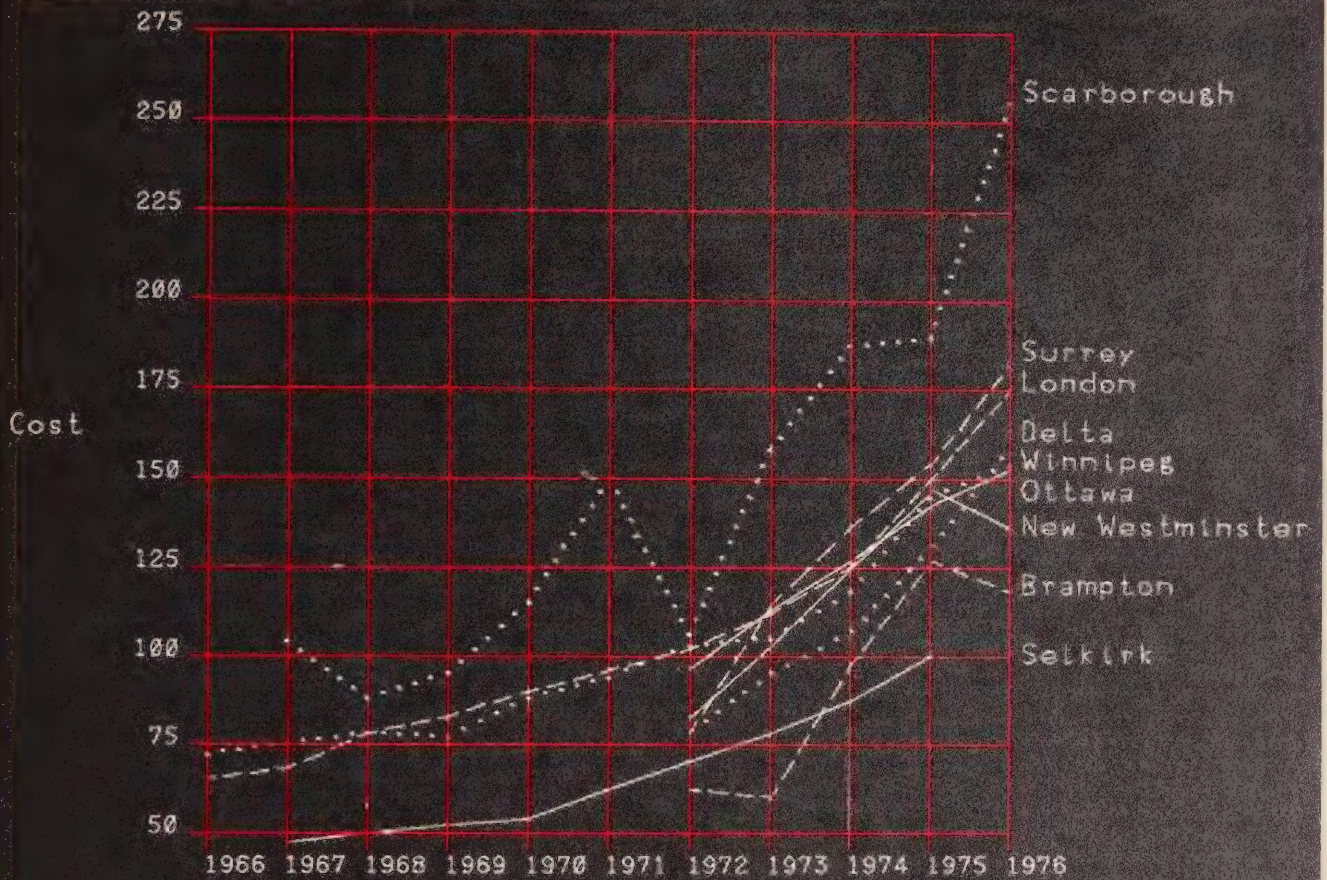
**Whether To Compel When
You Cannot Persuade**

Many municipal engineers suspect that engineers acting for developers who advocate more value/effective standards want only to minimize the developers' up-front capital costs to the detriment of the municipalities' long-term maintenance costs. But some municipalities have pioneered more value/effective standards apparently without jeopardizing their maintenance costs.

So we suspect that the suspicions voiced by these municipal engineers may mask an unwillingness properly to review and apply the new techniques which are now available.

(1) Reference: Chapter 8, Volume Two

Figure 4.D Servicing Cost Increases Can Be Controlled



Title: Total Costs for Internal Servicing of Residential Subdivisions
(Cost in \$ per Linear Foot of Roadway)

Source: Research Studies Volume, Chapter 9

4. Long-Run Price Determinants: Public Sector Controversies

4.2.3 The Financial Burden Of Land Development

At one time municipalities installed all hard services within subdivisions. Now, because of financial weakness, they require the developers to do so. (Most Quebec municipalities are an exception.) The financial importance of their imposing this responsibility on developers can scarcely be exaggerated. Our research shows that hard services, not raw land, are the major cost in producing serviced lots, typically ranging between about 35% and 70% of total lot costs.

Finding 15 BECAUSE OF COMPELLING FINANCIAL WEAKNESS, MUNICIPALITIES HAVE DELEGATED TO DEVELOPERS THE RESPONSIBILITY FOR LOCAL SERVICING. THIS DELEGATION OF RESPONSIBILITY HAS HAD AN UNINTENDED EFFECT. SINCE THEY NO LONGER PAY FOR LOCAL SERVICES, MUNICIPALITIES HAVE NO INCENTIVE TO ADOPT THE MOST VALUE/EFFECTIVE SERVICING TECHNIQUES. THE EXCESSIVE AND/OR OBSOLETE STANDARDS WE OBSERVE IN MANY MUNICIPALITIES ARE A PREDICTABLE RESULT.

Lot levies and taxes share a similarity with servicing costs; they are all non-land costs.

Recently many major municipalities, especially in Ontario and British Columbia, have had to impose a second type of new cost on developers. While these municipalities generally continue to install the trunk services to subdivisions, they now impose lot levies to force developers to pay their appropriate share of the costs. Levies range from nil in most Quebec municipalities to about \$4,000 per single-detached lot in some Ontario municipalities.

In 1974 the federal government imposed a third new cost on developers by forbidding them to deduct as expenses, in the year incurred, carrying costs for undeveloped land like mortgage interest and property taxes. Although these current costs may be deducted later when the land is sold, the immediate impact is to raise the effective carrying costs on undeveloped land and to reduce cash flow. Lot levies have a similar effect, for each increases costs prior to the receipt of revenues from sales. Each therefore increases the financial resources needed by developers. Ottawa's argument may be correct that in the short run non-deductibility forced some developers to put more land on the market. But in the long run developers will respond by buying raw land later rather than developing it sooner.

Finding 16 DURING THE BOOM, LOT LEVIES AND NON-DEDUCTIBILITY, LIKE SERVICING COSTS, LIKELY HAD LITTLE IMPACT ON THE SUPPLY OR PRICE OF SERVICED LAND. PRICES WERE

4. Long-Run Price Determinants: Public Sector Controversies

in some places with

DEMAND-DETERMINED AND DEVELOPERS WERE REALIZING VERY LARGE PROFITS. DEVELOPERS PROBABLY ABSORBED THESE COSTS AND REDUCED THEIR WINDFALL PROFITS.

Pass It Back,
Pass It Forward,
Pass It Sideways

WE CANNOT BE CERTAIN ABOUT HOW THESE COSTS AFFECT PRICES IN THE LONG RUN. MOST LIKELY THEY ARE PASSED AROUND IN A COMPLEX WAY: A PORTION IS PASSED BACK TO FARMERS IN LOWER PRICES FOR RAW LAND; A PORTION IS PASSED FORWARD TO HOUSE BUYERS IN HIGHER PRICES FOR LOTS.

TO THE EXTENT THAT LOT LEVIES MAY IN SOME MUNICIPALITIES EXCEED ACTUAL MUNICIPAL COSTS FOR THE LOTS SOME WEALTH MAY BE PASSED SIDeways FROM DEVELOPERS, FARMERS AND HOME BUYERS TO EXISTING RESIDENTS AS THOSE MUNICIPALITIES CASH IN ON THEIR PLANNING CONTROL BY "SELLING" SUBDIVISION APPROVALS.

But no matter how they may be passed around, in the long run each of these costs should increase prices to home buyers.

4.3 Citizen Resistance
To New Residential
Development

Staying Put Versus
Moving On

Existing residents believe they have a "right" to keep their neighbourhoods familiar and their house prices up. Potential residents believe they have a "right" to improve their lives by moving into affordable housing in good neighbourhoods.

When existing ratepayers fight new and cheaper housing, these two basic Canadian "rights" are pitted against each other.

In four projects in Halifax, Burlington, Toronto and Cambridge, we tried to isolate and measure the number of cheaper units lost and extra costs incurred directly attributable to nearby ratepayers.

The Main Ground
Rule

Our most important criterion for selecting cases to be studied was that the municipal council or planning staff had to have made some decision in favour of the initial proposal. This initial decision provided us with an objective benchmark against which to calculate the extra costs incurred and cheaper units lost.

We closely examined almost a score of ratepayer cases in order to isolate even four which satisfied this and other necessary criteria. They cannot claim to be representative; but they do illustrate the processes at work in many other areas of the country.

Two Of The Cases

In the Bedford Glen case in Toronto, neighbouring residents organized into a ratepayers association resisted a proposal by Cadillac Developments for two high rise apartment towers plus 19 row houses.

4. Long-Run Price Determinants: Public Sector Controversies

Cadillac had assembled the vacant and poorly-maintained site at the request of the mayor. The ratepayers objected to the proposed density as incompatible with their neighbourhood, not to development as such. As a result of the ratepayers' objections, 593 rental apartments and town-houses were rejected. They were originally targeted for completion in June, 1971; the project of which they formed a part is now scheduled for completion in August, 1978. The units which did get approved are of much lower density and are expensive condominiums compared to the relatively cheaper rental units which were rejected.

Without resistance by the existing Bedford Glen residents, 593 such units would probably have been supplied to the Toronto market in 1971, just before the demand boom. In fact, no units were supplied during this critical period. Currently the Toronto market has a shortage of rental units and an excess of condominiums.

A second project we studied is called the Kings Arms project, in Dartmouth, Nova Scotia. Resistance by neighbouring residents centered on the issue of traffic. No units were lost but extra costs were incurred. Because it is a limited dividend project funded by CMHC, we were able to obtain an objective analysis of the extra costs. The neighbours forced changes in design and delays in construction; rents for each of the 125 units therefore had to be increased to cover additional costs of \$103,166.

The Future Home Buyer: Unheard And Unrepresented

In measuring these cheaper units lost and extra costs incurred, we are implying neither that citizen resistance creates no improvements to the urban environment nor that existing residents be excluded from the planning process. It is clear, however, that the potential consumers who pay these costs and are denied these lost units are excluded from the process.

Unavoidably, municipal councils represent existing residents. No one, anywhere, directly represents the interest of potential residents. They have neither direct advocates nor a forum in which to weigh a municipality's housing needs against the arguments of existing residents. This is common to both citizen and municipal resistance to development. Without effective representation for the interest of future home buyers, this unavoidable bias in our political system permits existing residents and municipalities, each for separate reasons, easily to restrict or highgrade growth.

4. Long-Run Price Determinants: Public Sector Controversies

The most frequent victims of this lack of representation are the future low and medium income residents of medium and high density development. This is precisely the type of project that public authorities currently encourage. Ironically, as soon as the future home buyer acquires his first house, his interest immediately shifts from wanting lower house prices to wanting higher.

Finding 17 IN SPITE OF THE ABOVE EXAMPLES OF EXTRA COSTS AND LOST UNITS, WE FIND THAT CITIZEN RESISTANCE TO NEW DEVELOPMENT WAS NOT A CONTRIBUTOR TO HIGH LOT AND HOUSING PRICES DURING THE BOOM. CITIZEN RESISTANCE IS A RELATIVELY NEW PHENOMENON AND AS WE SHOW ELSEWHERE IN THIS REPORT, PRICES WERE DEMAND-DETERMINED DURING THE RECENT PAST. WE FIND, HOWEVER, THAT FROM THE END OF THE BOOM ONWARD, CITIZEN RESISTANCE COULD BECOME AN INCREASINGLY IMPORTANT DETERMINANT OF LOT PRICES IN THE ABSENCE OF MECHANISMS TO PROVIDE MORE EFFECTIVE REPRESENTATION FOR THE INTERESTS OF THE POTENTIAL HOUSING CONSUMER.

4.4 Government Land Banking And Servicing

Since 1967 federal and provincial governments have spent about \$775,000,000 on their joint land banking and servicing programs. In 1973 Ottawa sharply increased the available funds and several provinces took advantage of these extra funds to increase their land assemblies.

It is beyond our mandate to second-guess senior governments on whether or not they should be acquiring and servicing land banks. As earlier emphasized, we have tried to restrict this Report to the determinants of lot prices, questions large enough by themselves. We have therefore confined our case studies to a few large-scale assembly programs on the urban fringe which were intended to reduce overall price levels. Although some supporters of government land banking now deny it, the statement in 1973 of the then federal Minister of Urban Affairs quoted in Chapter 14 of Volume Two makes it explicitly clear that a major purpose of these assemblies was to reduce overall price levels. We emphasize this explicitly stated purpose because no matter what other objectives the programs may have had, our Report deals only with their influence on land and housing prices.

We caution that this too is one of the subjects in which we had to sacrifice comprehensive national coverage in favour of a small number of case studies which cannot claim to be representative but which are illustrative of the processes at work in markets of different sizes. In evaluating the performance of public sector land purchases

4. Long-Run Price Determinants: Public Sector Controversies

within this context, we have made findings about four basic considerations.

Our case studies involve various assemblies by three public corporations: Manitoba Housing and Renewal Corporation (MHRC); Ontario Housing Corporation (OHC); and Saskatchewan Housing Corporation (SHC).

**The First Consideration:
The Skill Of Government
Purchases**

We first examined their skill in making deals in the marketplace compared to deals made by private sector companies. SHC bought at or below the market prices paid by the private sector, MHRC bought at market prices, while in two of the OHC assemblies we studied, Ottawa and Milton, OHC generally paid above the market prices in the area.

**Small Is Cheap;
Big Is Dear**

We suggest that OHC's difficulty was caused primarily by the large scale of its purchases. In Milton and in Ottawa OHC created artificial markets by attempting large assemblies in specific locations. MHRC and SHC by contrast attempted smaller assemblies with more flexibility as to where the land was to be purchased. Some evidence of how large-scale purchases can drive up raw land prices comes from an expropriation case heard by the Federal Court of Canada in which the prices paid by OHC for its large 5,000 acre assembly near Ottawa became a major issue. After evaluating expert testimony by real estate brokers and appraisers, Mr. Justice Addy found, in part, that:

"It is evident, when examining the sales of lands adjacent to South East City immediately previous to and during the period of the land assembly, that the agents for OHC in the majority of the cases must have paid a much higher price per acre than the actual value at the time when one compares their purchases to other land purchases in the immediate vicinity. This can only be attributed to the artificially enhanced price caused by the joint announcement of the 11th of January, 1973, and by the activities pertaining to the land assembly.

"It is interesting to note that the price paid subsequent to the announcement increased most dramatically." (1)

Table 4.A sets out several specific examples of the higher-than-value prices paid by OHC in this Ottawa area assembly.

(1) Reference: Chapter 14, Volume Two

Table 4.A

PURCHASES BY ONTARIO HOUSING CORPORATION
TOWNSHIP OF GLOUCESTER (OTTAWA REGION)

	Purchased by Private Individual	Purchased by Ontario Housing Corporation
Parcel A 211.5 acres	October 1972 \$ 283.57/acre	May 1973 \$ 1,606.00/acre
Parcel B 37.5 acres	October 1972 \$ 347.00/acre	April 1973 \$ 1,692.00/acre
Parcel C 24 acres	April 1971 \$ 384.30/acre	July 1973 \$ 1,611.00/acre
Parcel D 35 acres	August 1972 \$ 775.84/acre	February 1973 \$ 1,593.00/acre
Parcel E 31 acres	June 1971 \$ 482.37/acre	October 1973 \$ 1,799.00/acre
Parcel F 26.5 acres	September 1971 N/A	March 1973 \$ 1,323.00/acre
Parcel G 36 acres	July 1972 \$ 775.00/acre	February 1973 \$ 1,593.00/acre

SOURCE: Task Force Research Studies Volume,
Chapter 14.

4. Long-Run Price Determinants: Public Sector Controversies

Finding 18 CRITICS OF PUBLIC LAND BANKING OFTEN CHARGE THAT GOVERNMENTS ARE BOUND TO PAY MORE FOR LAND THAN PRIVATE DEVELOPERS BECAUSE THEY ARE INHERENTLY INEFFICIENT AND CLUMSY. OUR EVIDENCE DOES NOT SUPPORT THIS CHARGE. MANITOBA HOUSING AND RENEWAL CORPORATION BOUGHT AT MARKET AND SASKATCHEWAN HOUSING CORPORATION IN SOME CASES BOUGHT BELOW MARKET. WE THEREFORE CONCLUDE THAT THERE IS NO INHERENT DIFFICULTY IN GOVERNMENTS ATTEMPTING TO BUY LAND AT MARKET PRICES. HOWEVER, SOME OF ONTARIO HOUSING CORPORATIONS'S EXPERIENCE DEMONSTRATES THAT GOVERNMENTS RUN SERIOUS RISKS OF ARTIFICIALLY INFLATING PRICES WHEN THEY ATTEMPT LARGE ASSEMBLIES AT SPECIFIC LOCATIONS.

**The Second Consideration:
The Timing Of Government
Purchases And Sales** We examined the timing of purchases by the three government corporations, and found that all three bought heavily at or near the top of the boom.

For MHRC we draw from the work of Professor Ruben Bellan.

MHRC responded immediately and heavily in 1973 to Ottawa's offer of increased funding for provincial land banks, and by 1976 had bought over 3,000 acres in the Winnipeg area. Professor Bellan concluded that the heavy purchases by MHRC and a private firm, Qualico Developments Limited, were "another major factor in the increase of raw land prices after 1972", and their purchases "had a marked effect on land prices".(1) He emphasized that MHRC bought heavily at precisely the wrong time and thus contributed to rapidly rising land prices. It bought raw land at or near the top of the market not to replace inventory but to add to inventory.

Further, during this period MHRC did not put a single serviced lot onto the market. MHRC is not planning to market its first lots until the spring of 1978, coinciding with a soft market. OHC during the boom did market lots from two major, older assemblies acquired at pre-boom prices and in those assemblies its timing was successful. But during this period it did not market any lots from its several new assemblies acquired immediately before or during the boom in Milton, Ottawa and elsewhere.

Finding 19 WE CONCLUDED IN FINDING 18 THAT GOVERNMENTS ARE NOT INHERENTLY INEFFICIENT OR CLUMSY. IN LAND BANKING HOWEVER THEY MAY BE INHERENTLY LATE. THE REASON IS THAT THEY FACE AN INHERENT CIRCULAR

(1) Op. cit., p.33

4. Long-Run Price Determinants: Public Sector Controversies

CONTRADICTION. UNDER THE PRESSURES CAUSED BY THE BOOM, SENIOR GOVERNMENTS INTENSIFIED THEIR COMMITMENT TO LAND BANKING IN 1973, INCREASING FUNDING ON JOINT LAND BANKS THAT YEAR FROM ABOUT 75 MILLION DOLLARS TO ABOUT 185 MILLION DOLLARS, WITH OTTAWA PROMISING TO SPEND HALF A BILLION DOLLARS OVER THE NEXT SEVERAL YEARS. GOVERNMENTS CANNOT LAUNCH PROGRAMS OF THIS MAGNITUDE UNTIL THE PRESSURES HAVE DEVELOPED; BUT ONCE THE PRESSURES EXIST, INEVITABLY THE PROGRAMS ARE TOO LATE. THERE CAN BE NO DOUBT THAT THE ENTRY BY STRONG, RICH BUYERS INTO A MARKET WHICH WAS ALREADY OVERHEATED PUSHED UP RAW LAND PRICES.

SUCCESSFUL LAND BANKING REQUIRES SUCCESS IN TIMING. THE RAW LAND SHOULD BE BOUGHT WHEN MARKETS ARE SOFT AND THE FINISHED LOTS SOLD WHEN MARKETS ARE RISING. FOR THE MAJORITY OF ASSEMBLIES STUDIED PERFORMANCE IN THOSE RESPECTS DURING THE BOOM WAS POOR AND COULD HAVE NEITHER SMOOTHED OUT FLUCTUATIONS NOR DEPRESSED PRICES. MANITOBA HOUSING AND RENEWAL CORPORATION, ONTARIO HOUSING CORPORATION AND SASKATCHEWAN HOUSING CORPORATION ALL BOUGHT HEAVILY DURING THE BOOM. BUT MHRC DID NOT SUPPLY ANY LOTS. OHC DID SUPPLY LOTS FROM OLDER ASSEMBLIES, BUT SUPPLIED NONE FROM THE SEVERAL LARGE ASSEMBLIES IN OTTAWA, MILTON AND ELSEWHERE ACQUIRED IMMEDIATELY BEFORE OR DURING THE BOOM.

The Third Consideration: Windfall Profits

Supporters of government land banking frequently argue that governments can supply lots more cheaply than private industry because they do not take windfall profits. This argument contains two crucial assumptions.

The first assumption is that because land prices will automatically increase at more than "normal" rates of return, opportunities for windfall profits will always exist. Both current experience and basic research challenge this assumption. In large parts of Canada real land prices have fallen since the boom. And our research demonstrates that raw land prices fluctuate considerably.⁽¹⁾ Over the long term, periods of falling prices and financial losses are inevitable.

The second assumption is that where opportunities for windfall profits do exist, governments will never be tempted to cash in. The largest government land assembler, Ontario, provides the most current evidence. In March, 1977 that government dramatically abandoned the production of lots and announced its intention to sell off the remaining

(1) Reference: Chapter 6, Volume Two

4. Long-Run Price Determinants: Public Sector Controversies

lands in its large Malvern and Kitchener-Waterloo assemblies *at market prices*.

Buy Low And Sell
At Market

Because Malvern is an ancient assembly in Metro Toronto bought at 1950's prices and because the Kitchener-Waterloo assembly was also purchased at pre-boom prices, these sales could create very large windfall profits. Ottawa is a 75% partner in these profits. But according to one federal minister responsible for housing, Malvern was acquired to enable lots to be sold *below market*. During the hearings in 1968 of his housing task force, the Honourable Paul Hellyer said:

"That's why the federal and provincial governments bought the land at Malvern in 1953 - to break the land market, to squeeze the speculators." (1)

Finding 20

GOVERNMENTS DO SOMETIMES TAKE WINDFALL PROFITS. WE FIND DEFICIENT, THEREFORE, THE ARGUMENT THAT GOVERNMENTS CAN SUPPLY LOTS MORE CHEAPLY THAN PRIVATE INDUSTRY BECAUSE THEY DO NOT TAKE WINDFALL PROFITS. THIS ARGUMENT SHOULD NOT IN FUTURE BE PERMITTED TO INFLUENCE GOVERNMENT LAND POLICIES.

UNDOUBTEDLY SOME GOVERNMENTS HAVE RESISTED THE OPPORTUNITY TO TAKE WINDFALL PROFITS. HOWEVER, IF GOVERNMENTS DO NOT TAKE WINDFALL PROFITS WHEN MARKETS ARE GOOD, WHO WILL SUBSIDIZE WINDFALL LOSSES WHEN MARKETS ARE SOFT, AS IS NOW THE CASE IN MANY AREAS?

The Fourth Consideration:
Did Government Land Banks
Reduce House Prices
During The Boom?
Back To The 95% Dog
And The 5% Tail

Earlier we found that large increases in new house production could not significantly moderate price increases in existing housing in the short run. We concluded that restrictions by developers and municipalities, by planners and ratepayers, could not have *caused* the house price boom. In the same way, heavy government lot production could not have *prevented* the house price boom.

In any event, as we have observed, provincial governments during the boom frequently were not able to transform their then recent land banks into marketable lots. It is true that the Ontario government was able to produce large numbers of lots during the boom from older land banks. When these lots were leased or sold at below-market value, they benefited the lessees or purchasers directly. However, they had, and could have had, no discernible impact on the escalating price of houses generally. Table 4.B shows that Regina's

(1) Reference: Chapter 6, Volume Two

4. Long-Run Price Determinants: Public Sector Controversies

policy of cranking out *lots* from the private sector at a high rate did not prevent *house* prices from doubling during the boom.

Finding 21 THE DATA SHOW THAT DURING THE BOOM LARGE-SCALE GOVERNMENT ASSEMBLIES HAD NO MODERATING EFFECT ON HOUSE PRICES. TABLE 4.B ILLUSTRATES THEIR IRRELEVANCE BY DEMONSTRATING THAT THE HOUSE PRICE INCREASES IN SIX URBAN AREAS WITH HIGH GOVERNMENT OWNERSHIP WERE NOT SIGNIFICANTLY DIFFERENT THAN THE HOUSE PRICE INCREASES IN ALL 25 URBAN AREAS WE STUDIED. THEREFORE, A MAJOR PURPOSE OF THESE ASSEMBLIES, REDUCTIONS IN OVERALL PRICE LEVELS DURING THE BOOM, WAS NOT ACHIEVED.

Figures 4.E and 4.F reorganize the relationships presented in Table 4.B for each year from 1966 to 1975. They make it clear that the performance of dwelling prices in cities with high government ownership is virtually the same as in our entire sample of 25 urban areas.

Table 4.B

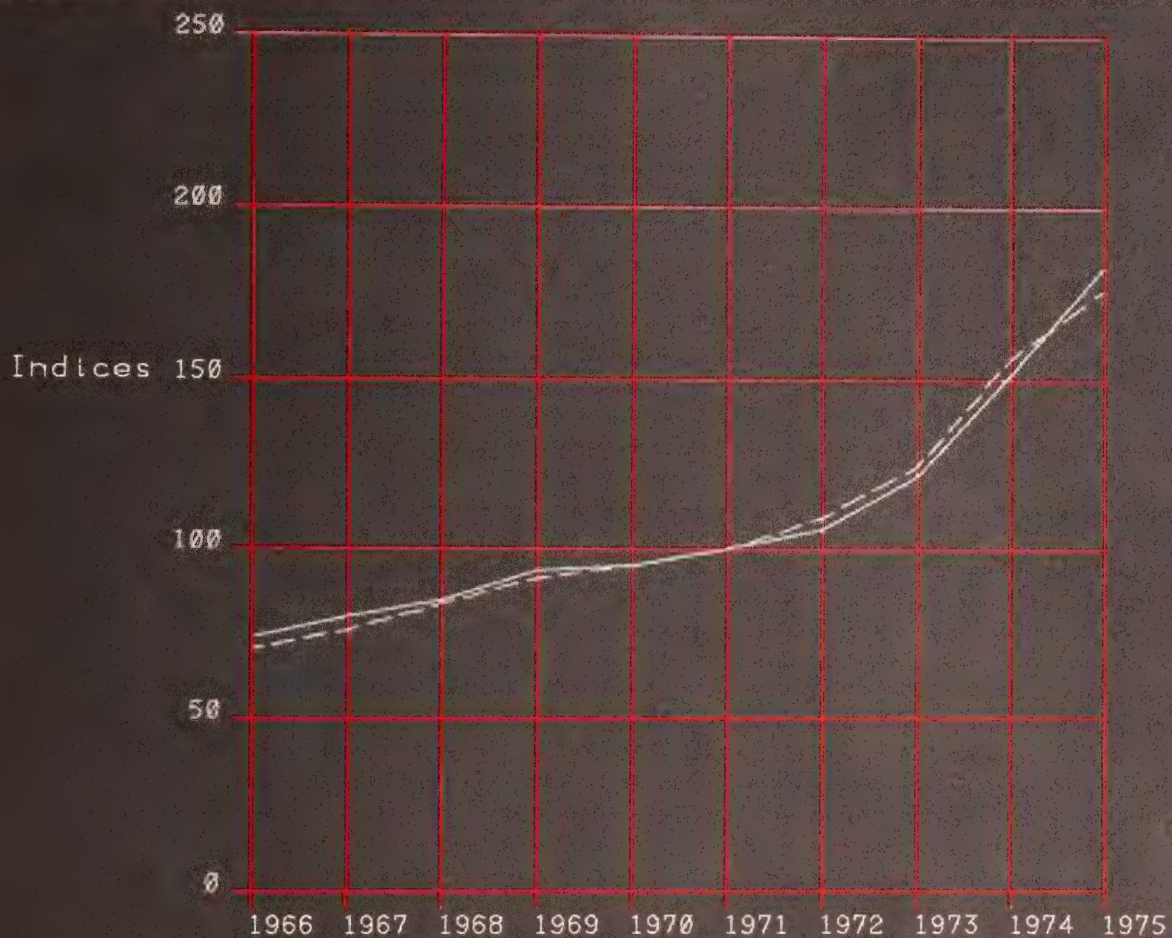
AN ILLUSTRATION OF THE IRRELEVANCE OF PUBLIC VERSUS
PRIVATE LAND OWNERSHIP FOR SHORT-RUN HOUSING
PRICE FLUCTUATIONS

Urban Areas with High Government Ownership	Percentage Change, 1972-1975	
	MLS Dwelling ¹ Prices	NHA Dwelling ² Prices
Regina	99.1	75.1
Saskatoon	101.5	71.7
Winnipeg	71.5	81.6
Ottawa	52.9	64.0
Halifax	44.9	26.7
Saint John	68.7	17.8
Average	73.0	56.2
Average of 25 urban areas	62.3	57.4
Difference	+10.7%	-1.2%

1. SOURCE: Table A5 - Appendix 1, Volume Two

2. SOURCE: Table A8 - Appendix 1, Volume Two

Figure 4.E Public Land Ownership Had No Discernible
Effect On House Prices



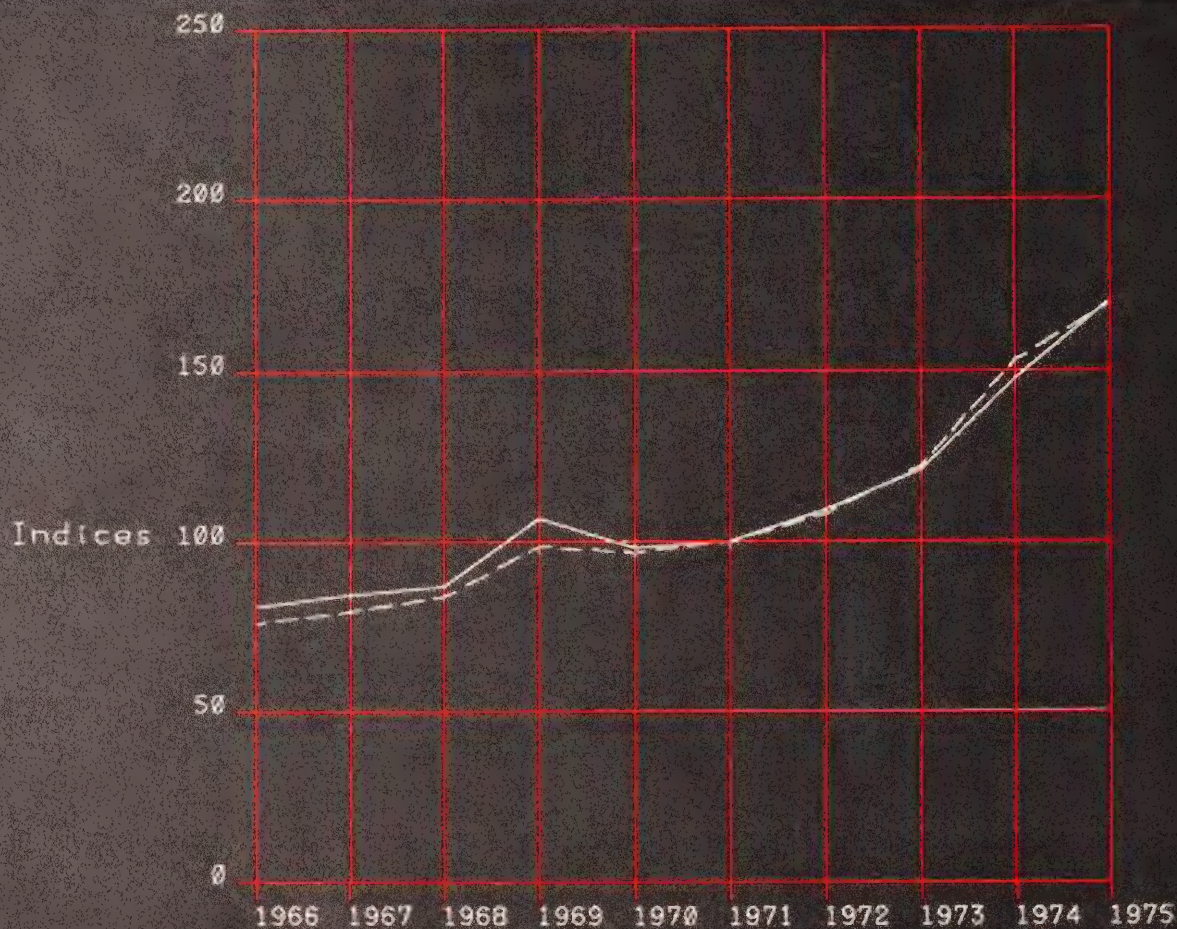
Title: Indices of MLS Dwelling Prices (1971=100)

———— Average of 6 Urban Areas with High Government Ownership

----- Average of 25 Urban Areas

Source: Table A.5, Appendix 1 of Volume Two

Figure 4.F Public Land Ownership Had No Discernible Effect On House Prices



Title: Indices of NHA Dwelling Prices (1971=100)
—— Average of 6 Urban Areas with High Government Ownership
----- Average of 25 Urban Areas

Source: Table A.8, Appendix 1 of Volume Two

5. Long-Run Price Determinants: Private Sector Controversies

5.1 High Prices And High Profits, Which Caused Which?

The conventional wisdom is that developers recently made very high profits. The conventional wisdom is correct.

The data to measure these profits for individual subdivision projects are not available publicly. Surprisingly, they are not available privately either. Individual developers neither share the data nor calculate them in any consistent way. Yet any report on development process without information on developer profits would have been extremely inadequate.

We therefore precipitated a study of subdivision costs and profits. To carry it out, an ad hoc committee of five industry members in Alberta, three in British Columbia and 13 in Ontario retained the consulting firm of Peat Marwick and Partners. For all three groups, the Task Force, the 21 participating developers and Peat Marwick, this study was an original effort.

We approached the study cautiously, assigning Task Force experts in finance, accounting, economics, planning, development and engineering. They developed the basic questionnaire used to collect the data from the participating developers, ensured that the final sample of subdivisions studied contained many *very* profitable projects, evaluated all the steps, methodologies and assumptions and satisfied themselves that those of the study's final conclusions from which we draw are reasonable and supported by the data.

From this study we obtained an analysis of 51 completed subdivisions. They are of different sizes and by different developers, started at different times and took different lengths of time to complete. Thirty-three subdivisions were in Ontario, 12 in Calgary and Edmonton and six in Vancouver.

We believe this is the first time such private sector information has either been prepared or made public.

Some Cautions

The sample selected was biased towards profitability. All but one were profitable, and many in the sample were *very* profitable.

The sample represents only what the 21 participating developers do at the level of individual projects; it does not represent all projects completed during the period by all developers.

5. Long-Run Price Determinants: Private Sector Controversies

All the participating companies were successful and large. The sample therefore cannot necessarily tell us anything about the financial results obtained by smaller companies. This qualification is not to imply that the latter may not have had similar success.

Nevertheless the individual and combined opinions of the Task Force experts assigned to this study is that these cautions are not likely to have a serious effect on the final results.

Another Check Simultaneously, as another independent check on the data provided by the developers participating in the study, we prepared a completely separate analysis of the *overall* financial performance of 15 public land development corporations based on the information such companies are required to file publicly.(1)

Some Ground Rules Because the subdivisions studied varied considerably in size, management, profitability, starting time and duration, profits were calculated on the basis of the average return realized in each year of the project. This measure of profits in each year gives effect to the time value of money. During most years of a project, before any sales take place, the return on investment typically is negative. Then, as sales are achieved, the break-even point is realized and afterwards the profits begin to be realized. The advantage of this annual rate of return analysis is that it smooths out these differences over time, like a moving film.

Unfortunately, some analysts calculate profits by taking only two static snapshots, one at the beginning of a project and one at the end. This method has the effect of highlighting the gross amount of the profit while ignoring the number of years necessary to earn it. It thereby ignores the value of money over time. It is rather like acknowledging that Roger Bannister ran the mile, but without saying how long he took. It also ignores the basic test of return on investment. It is both misleading and meaningless.

Finding 22 THE SUBDIVISION STUDY CONFIRMS THAT SUBDIVISION PROFITS WERE VERY HIGH DURING THE EARLY AND MID 1970'S.

On the Ontario subdivisions the developers made a median profit of about 18.5% on total investment *after tax* over the period studied and in Alberta

(1) Reference: Research Studies Volume, Chapter 6

5. Long-Run Price Determinants: Private Sector Controversies

and Vancouver about 15%. Because of the small sample sizes in Alberta and Vancouver, this difference is not statistically significant. Figure 5.A shows the distribution of these after-tax returns for the 33 projects studied in Ontario.

These after-tax returns of about 15% and 18.5% were in *pre-tax* terms approximately three times the cost of borrowed funds. To the extent therefore that developers were able to recover triple the interest they were paying for borrowings to finance their projects, the consequential return on their own equity funds must have been very impressive indeed. To some extent this explains the very high growth rate in their total assets during this period which our overall financial analysis documents.

Our financial analysis was both separate and different from the Peat Marwick study; it analysed *total* corporate performance of 15 large public companies rather than 51 individual subdivisions. Nevertheless, it generally confirms the Peat Marwick conclusions; during the boom, average pre-tax returns on equity in land development were generally between 30% and 40%.

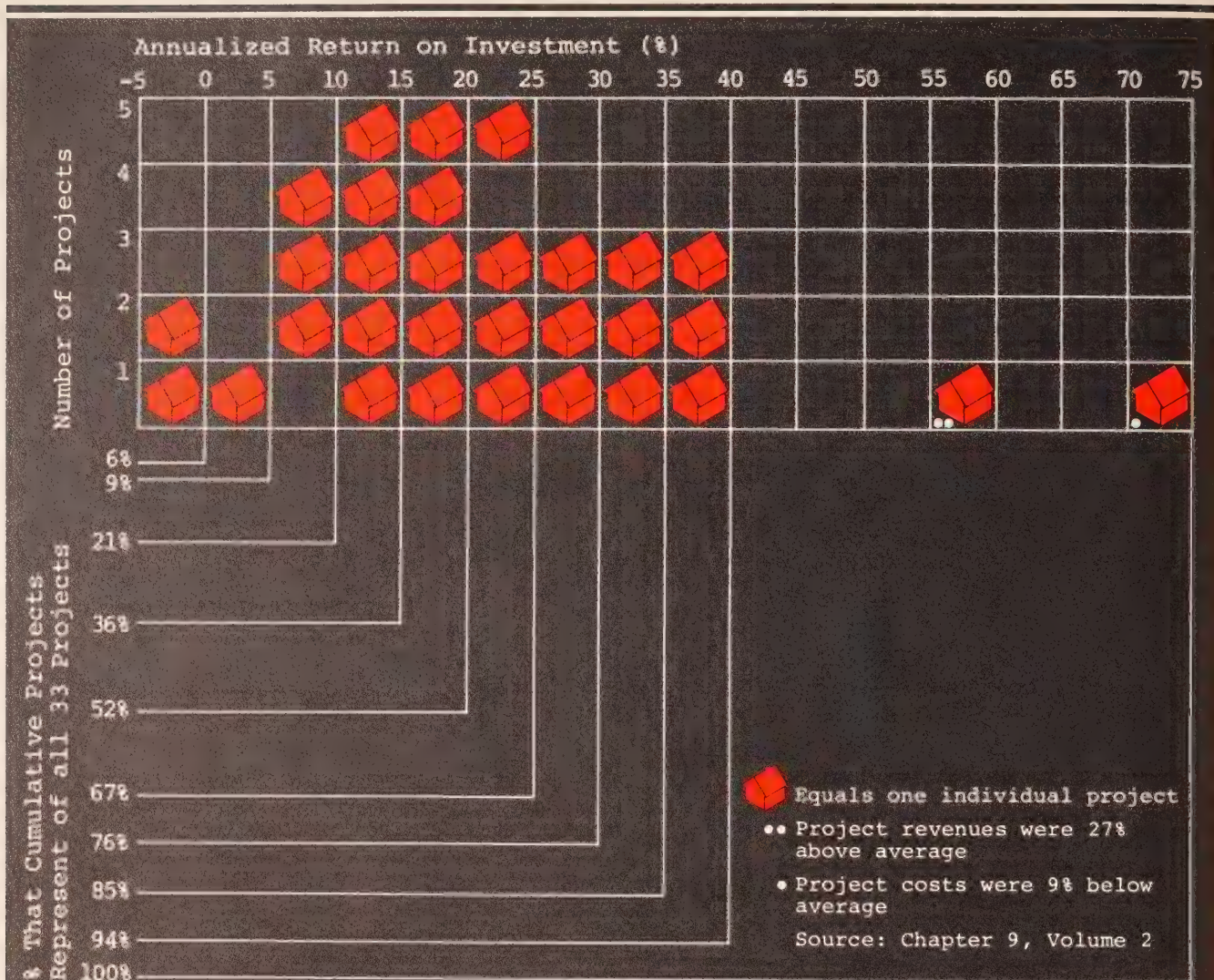
Finding 12 [THE SUBDIVISION STUDY LENDS STRONG SUPPORT TO OUR
Revisited EARLIER FINDING ON SERVICING COSTS THAT DURING THE BOOM, LOT PRICES WERE NOT DETERMINED BY THE COST OF SUPPLYING LOTS. THIS FINDING IS ALSO CONSISTENT WITH OUR EARLIER ARGUMENT THAT FACTORS AFFECTING THE PRODUCTION OF NEW HOUSING WERE NOT PRIMARILY RESPONSIBLE FOR THE BOOM. THE DEVELOPERS MADE SO MUCH MONEY BECAUSE PRICES WENT UP SO MUCH FASTER THAN COSTS. HIGH PRICES CAUSED HIGH PROFITS; HIGH PROFITS DID NOT CAUSE HIGH PRICES.) JOHN KENNETH GALBRAITH SAID IT WELL: FINANCIAL GENIUS CONSISTS OF SHORT MEMORIES AND RISING MARKETS.

**High Prices Precede
High Profits**

Finding 23 FEW SELLERS ANTICIPATED THE BOOM. THEREFORE LAND BOUGHT BY DEVELOPERS DURING THE 1950'S AND 1960'S DID NOT ACCURATELY REFLECT FUTURE VALUES.

Finding 24 THERE IS NO EVIDENCE THAT PROFITABILITY WAS RELATED TO THE LENGTH OF TIME THE DEVELOPER BANKED THE LAND. PROJECTS BASED ON CHEAP LAND BOUGHT MANY YEARS BEFORE DEVELOPMENT DID NOT EARN RETURNS SIGNIFICANTLY DIFFERENT FROM RETURNS EARNED BY PROJECTS BASED ON MORE EXPENSIVE LAND BOUGHT ONLY SHORTLY BEFORE DEVELOPMENT. THIS DOES NOT MEAN THAT HOLDING CHEAP LAND FOR A LONG TIME WAS NOT VERY PROFITABLE, MERELY THAT IT WAS NOT NECESSARILY MORE PROFITABLE THAN HOLDING MORE EXPENSIVE LAND FOR A SHORT TIME. THIS APPEARS TO CONTRADICT THE CONVENTIONAL WISDOM.

Figure 5.A Profitability of 33 Completed Subdivision Projects in Ontario



Profitability of 33 Completed Subdivision Projects in Ontario
 Distribution of Annualized Returns on Investment (ROI) for
 Projects Completed in the Period 1969-1977

5. Long-Run Price Determinants: Private Sector Controversies

Finding 25

Bigger Is Not Necessarily Richer

THE EVIDENCE DOES NOT SUPPORT THE THEORY THAT LARGER PROJECTS MEANT LARGER PROFITS. SCALE DID NOT INFLUENCE PROFITS. INDEED, THERE MAY HAVE BEEN A SMALL NEGATIVE RELATIONSHIP BETWEEN SIZE AND PROFIT. THIS TOO APPEARS TO CONTRADICT THE CONVENTIONAL WISDOM.

Many have assumed that large projects are inherently more profitable than small projects. This assumption has been used as one argument in favour of government land banking, on the grounds that government has the financial resources for lucrative large-scale development. In light of the above results, this position ought now to be reconsidered.

The Inventory Replacement Issue: Developers Cry Poor

The development industry persistently argues that its high profits from completed subdivisions are "necessary". While the boom conferred record profits for developed land, it also imposed record prices for raw land, and the argument is that the high profits have to be reinvested in expensive raw land simply for developers to stay in business. In essence, the industry is arguing that its stated profits during the boom are false indicators of its real profits.

We reject this argument completely. It confuses cause and effect. Raw land prices are high because developers are willing to bid high. They bid high because they expect high future profits. We do not accept the notion that they would bid high if they did not expect to continue to make profits at those high prices. If their past profits and their expectations of future profits were lower, their competitive bids would be lower; hence raw land prices would be lower too.

Finding 26

HIGH PRICES FOR RAW LAND ARE CAUSED BY HIGH LEVELS OF PAST PROFITS AND HIGH EXPECTATIONS FOR FUTURE PROFITS. THE ARGUMENT BY DEVELOPERS THAT PROFITS HAVE TO BE HIGH IN ORDER TO ENABLE THEM TO AFFORD HIGH RAW LAND PRICES IS CLEARLY BACKWARDS. THE OPPOSITE IS TRUE. RAW LAND PRICES ARE HIGH PRECISELY BECAUSE THEIR PAST PROFITS AND EXPECTED FUTURE PROFITS ARE HIGH.

This is not to deny that developers have had severe liquidity problems, caused by prices of production and inventory rising faster than average price levels. But this is the same liquidity problem faced by any would-be entrant to the industry; he too would face high inventory costs.

5. Long-Run Price Determinants: Private Sector Controversies

We find therefore that no special interpretation of developers' accounts is warranted and no special attention to their need for inventory replacement is justified.

Finding 27 A FEW NOTABLE EXCEPTIONS APART, FINANCIAL RESULTS OF LEADING PUBLIC LAND DEVELOPMENT COMPANIES FOR FISCAL 1977 CONFIRM AN INDUSTRY-WIDE TREND TO LOWER RETURNS ON ASSETS. THIS CURRENT TREND HAS BECOME EVIDENT ONLY DURING THE LATER PART OF OUR WORK. (IN ABSOLUTE TERMS, LAND DEVELOPMENT PROFITS REMAIN HIGH TODAY, BUT RELATIVE RATES OF RETURN HAVE PEAKED AND ARE NOW DECLINING. THEY ARE NO LONGER DISPROPORTIONATE TO THE INDUSTRY'S HEAVY CURRENT INVESTMENT IN LAND.)

**The Past: Profitable
The Future: Unpredictable**

(WE THEREFORE SUGGEST TO PUBLIC POLICYMAKERS THAT THE VERY HIGH PROFITS OF THE RECENT PAST COULD BE MISLEADING AS A GUIDE TO PUBLIC POLICIES FOR THE FUTURE. NOW THAT MARKETS ARE NO LONGER RISING AUTOMATICALLY, IF AT ALL, THE INHERENT UNPREDICTABILITY OF THE DEVELOPMENT BUSINESS WILL NO LONGER BE MASKED.)

**5.2 Is The Development
Industry Concentrated Now?**

**The Boom Caused The High
Increases, But Did The
Developers Cause The
High Levels?**

A widespread theory holds that a few developers in each market own enough land to hold out sufficient lots to drive up prices beyond competitive levels. This theory is frequently used to explain the extreme price increases of the boom. As we have shown earlier, it is not the explanation for the boom.

However, the mere fact that the boom was caused by asset revaluation does not necessarily mean that developers do not have monopoly power. So we have tried to avoid a profound error. We cannot eliminate the possibility of developer monopoly power merely because asset revaluation is a better explanation for the extreme increases of the price boom.

(Both phenomena could exist side by side, monopoly power creating higher price levels than would exist in a competitive market, and asset revaluation creating the extreme increases beyond those higher levels.)

But the developers' high profits of the boom are not evidence of monopoly power. All landholders benefited from the unanticipated revaluation of land that took place during the boom, not least the millions of Canadians who own their own homes.)

(Our search for evidence of monopoly power clearly had to go beyond a simple superficial inspection of short-term price rises and short-term profits.

5. Long-Run Price Determinants: Private Sector Controversies

We therefore focused much effort in examining one of the pre-conditions for the exercise of monopoly power, the concentration of activity in the hands of only a small number of firms.) We tested this possibility in two ways.

Our First Test: Land Ownership

A frequent accusation is that developers rig markets through concentrated land ownership. We therefore intensely studied the degree of ownership concentration in 13 metropolitan areas; in each one we examined land that was similarly situated and that could be potentially developed within about five years.

Table 5.A shows the results. It presents our data for both nominal ownership and effective ownership. Nominal ownership is based on the owners' legal names only, while effective ownership is based on the linkages among nominal owners.

Compared to the volume of data examined, the time taken and the range and intensity of arguments canvassed, our conclusion is simple. (In each area (except perhaps Ottawa) the degree of private sector concentration is below those levels that would justify the monopoly-developer argument.

We reach this finding by applying the general ratios used by industrial organization economists when testing for monopoly power. Of course, those economists wisely do not like to be pinned down to a rigid rule. But a typical criterion is that for significant power to rig markets to exist, the top four sellers in an industry must control about 60% of a market; a few say 50% and some say 70%. While these ratios are anything but rigid, they do present us with an initial benchmark where little else exists against which to compare the development industry across Canada.

In three of the areas where ownership appears concentrated, Halifax, Regina and Saskatoon, government owners dominate. In Ottawa, Ontario Housing Corporation is the largest owner of undeveloped land; the four largest private owners control 43% of the sampled acreage.(1)

When examining private sector corporations we of course treated all linked companies as a single owner. The highest concentrations of private

-
- (1) Because some observers predict OHC's lands will never be developed, analysts disagree whether or not to include them in the ownership sample. Our decision was to include them.
-

Table 5.A

Ownership Concentration: Nominal and
Effective Ownership Statistics

Metropolitan Area	% owned by top 4 owners		% owned by top 10 owners		% owned by top 25 owners	
	Nominal	Effective	Nominal	Effective	Nominal	Effective
Calgary	30.4	46.1	51.5	62.2	70.3	72.2
Charlottetown	11.8	11.8	23.6	24.0	46.8	47.8
Edmonton	30.0	N.A.	50.0	N.A.	76.2	N.A.
*Halifax	73.9	73.9	85.6	86.8	96.4	96.4
Hamilton	21.0	21.0	32.7	32.7	47.3	47.3
London	30.7	32.5	47.3	49.8	69.2	71.0
Montreal	13.6	N.A.	24.1	N.A.	39.0	N.A.
*Ottawa	63.2	64.4	79.6	80.8	90.7	90.9
*Regina	58.3	58.3	83.5	86.3	N.A.	N.A.
*Saskatoon	84.5	98.1	99.2	99.8	N.A.	N.A.
Toronto	17.5	22.7	27.7	37.1	40.2	48.7
Vancouver	27.0	30.3	37.3	43.1	50.7	56.1
Winnipeg	48.7	49.5	64.8	66.4	74.2	75.5

* Areas with high public sector ownership

N.A. means not available

SOURCE: Chapter 7, Volume Two

5. Long-Run Price Determinants: Private Sector Controversies

ownership were in Winnipeg and Calgary, where the Big Four owned 49.5% and 46.1% of the land respectively. By the traditional criteria above, neither statistic is high.

As well, Hamilton, Toronto and Vancouver, like Winnipeg and Calgary, also had extremely rapid price increases in the boom. Yet their top four companies (with such small shares, one could scarcely call them the Big Four) owned respectively only 21%, 22.7% and 30.3% of the land.

(If monopoly developers caused the extreme price increases in Winnipeg and Calgary, what caused them in Hamilton, Toronto and Vancouver?)

Furthermore, Winnipeg and Calgary have the greatest potential for monopoly power, for each had a Big Four owning about 50% and 46% respectively. But we could not fail to be impressed at the very large number of developers who owned the remaining 50% of the land in Winnipeg and the remaining 54% in Calgary. Would it not be very difficult for the Big Four to make and enforce collusive deals among themselves when all the other owners are struggling and shoving so close behind?

Russia and perhaps the United States would like to run the world to suit themselves, but they are always limited by Romania, Israel, France and many others who are powerful enough not to have to toe the line. Similarly, economists agree that for sellers to be able to fix prices, they must be small in number. The reason is simple. In order to restrict supply, all the sellers must make an agreement that each seller will accept some limitation on his sales. This kind of collusive agreement always involves a struggle over the market shares allocated to each member of the club. Clearly, as the number of sellers becomes large, these agreements quickly become difficult to form and impossible to enforce.

Our Second Test:
Development
Approvals

However, the fact that there is no evidence for rigging markets at the land ownership stage does not mean that there is no rigging of markets at the later lot approvals stage. This is especially true because the approvals process is a licensing process. It absolutely determines how much land gets developed and where. Those licensing decisions are made by public authorities, not private developers. (It is therefore sometimes argued that what counts is not who owns the land but who develops the lots.) [The Big Four may not own enough undeveloped land to be able to control markets, but they may be able to get enough of the

5. Long-Run Price Determinants: Private Sector Controversies

approvals to do so.)

The evidence is limited in scope, but definite in direction. In a study for the Ontario Economic Council, Professor Andrew Muller(1) demonstrated that in the Toronto area the four largest land subdividers accounted for 33.4% of the approved building lots from 1971 to 1973 and that the top ten accounted for 53.5%. These figures are higher than the corresponding ownership statistics in a study for the Ontario Economic Council by Markusen and Scheffman(2) who show that the top four land owners held 22.7% and the top ten, 37.1%.

However, this degree of concentration at the approvals stage is also below the levels referred to above which would justify the monopoly-developer view.

(Further, any suggestion of monopoly power at the approvals stage is diminished by the ability of rival firms to enter the market in any market area. This is called the barriers-to-entry test and it is an extremely important pre-condition to a few developers being able to rig markets.

But this pre-condition is often overlooked by advocates of the monopoly-developer theory.)

It is important because if barriers-to-entry do not exist, new firms will enter even a highly concentrated industry as soon as it raises prices beyond competitive levels.) The empirical evidence on this point too is limited in scope, but also definite in direction.

In recent years, eastern firms like Bramalea, Markborough, Costain and Campeau have entered western markets. Western firms like Genstar, Nu-West and Carma have entered eastern markets. Sifton and Matthews were thought to have monopolized the market in London, Ontario; Wimpey and Monarch recently entered it. Genstar, Nu-West and Carma were said to have monopolized the market in Calgary; Markborough, Costain and Campeau have recently entered it. Similarly, Wimpey and Costain have entered the Edmonton market to compete with Nu-West, Genstar, Daon and Qualico.

(1) Op cit, p. 38

(2) Markusen, J.R. and Scheffman, D.: Speculation and Monopoly in Urban Development: Analytical Evidence for Toronto. University of Toronto Press, 1977.

5. Long-Run Price Determinants: Private Sector Controversies

All of these actual instances of entry form limited but tangible evidence that barriers-to-entry at the land development stage are not very significant.

We therefore find that anyone wishing to make a case for developers having the power to rig markets on the basis of concentration in the development stage *must be required to prove the existence of barriers-to-entry*. Existing evidence suggests that any attempt to do so will not be successful. That is why we concentrated our efforts on the first test, the ownership of undeveloped land.

Figure 5.B illustrates our basic reasoning. It divides the industry into two activities, land ownership and land development, and shows that *two* tests must be performed on each activity to assess whether or not market power exists.

Finding 28 (IN EACH DIRECTION THAT WE HAVE TRIED TO TEST THE MONOPOLY-DEVELOPER THEORY, OUR TESTS HAVE BEEN NEGATIVE. WE HAVE FOUND NO EVIDENCE THAT MONOPOLY POWER EXISTS IN EITHER THE LAND OWNERSHIP OR THE LAND DEVELOPMENT INDUSTRIES. WE WOULD THEREFORE BE MISGUIDED TO EXPLAIN LAND PRICES AS CONTROLLED PRICES.)

However, we emphasize that this finding reflects industry structure at only one point in time, 1977. It cannot possibly tell us if the development industry was or is becoming more concentrated over time. This is a very important question since there are several forces at work, discussed elsewhere in this Report, that may lead to higher concentration in the near future.

The Conspiracy Theory Revisited

We have a prediction. To some of the partisans of the monopoly-developer theory, the fact that this Task Force finds that there is no evidence that monopoly is a cause of high land prices will not defeat but merely confirm the conspiracy theory. It will merely provide more evidence of the pervasiveness of the conspiracy.

5.3 Might The Development Industry Become More Concentrated In The Future?

We have a detailed case study of a small developer who recently left the industry in Ontario.⁽¹⁾ In 1971 he had bought the "perfect" parcel; it lacked any of the common barriers to development.

Through a series of new requirements in the approval process, some caused by a new regional government, draft approval for a plan of subdivision was unexpectedly delayed until 1977. The

(1) Reference: Research Studies Volume, Chapter 13

5. Long-Run Price Determinants: Private Sector Controversies

reasons for the delay aptly fit our earlier description of horror stories in planning which are too unbelievable to believe but not too unbelievable to happen.

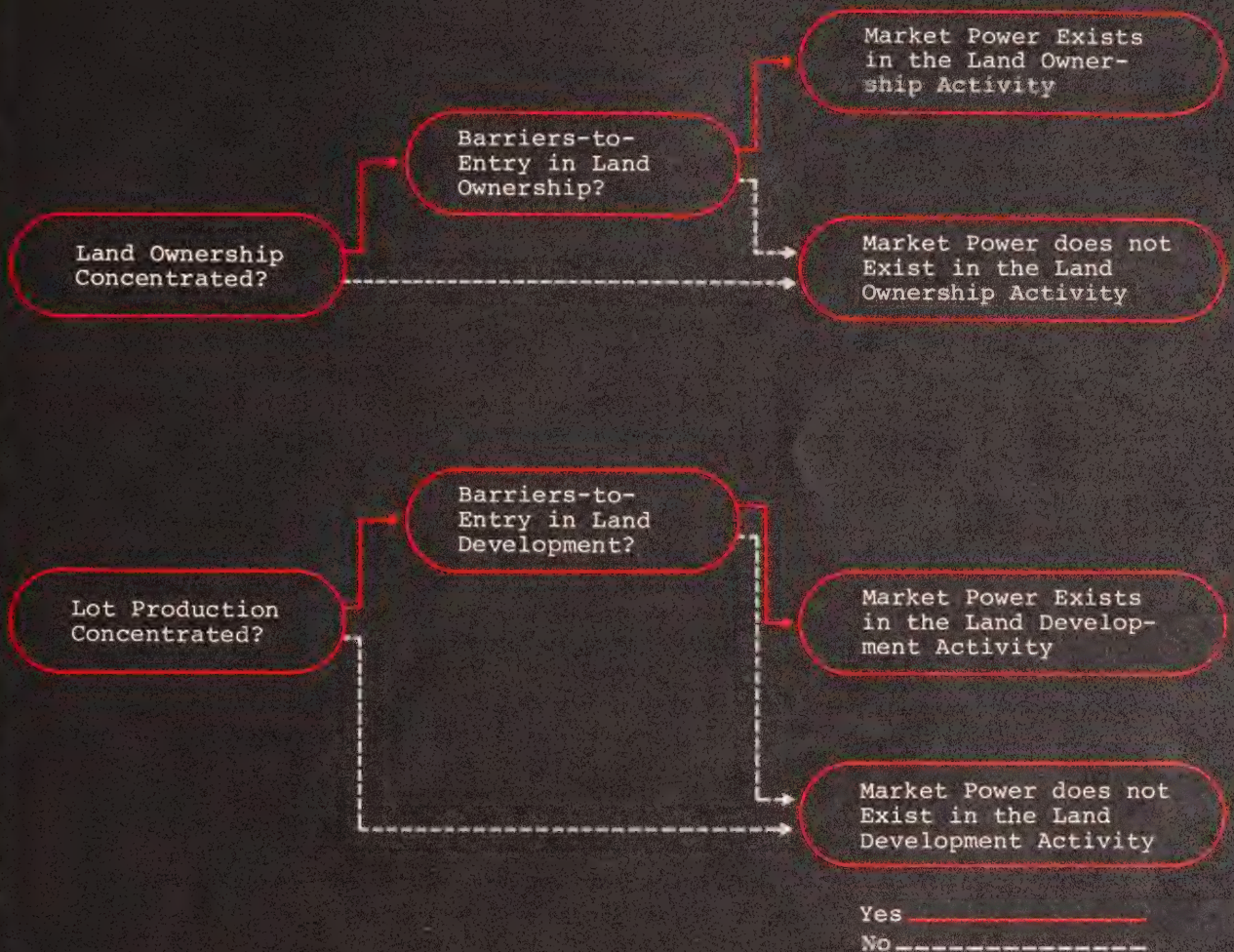
In the end, although the developer wanted to complete the development, he was not willing to risk the new and very large capital expenses imposed on him well ahead of sales revenues. As soon as he received draft plan approval he sold out and left the business entirely.

Finding 29 { IN SECTION 4.2.3 WE CONCLUDED THAT LOT LEVIES, NON-DEDUCTIBILITY OF CURRENT EXPENSES AND THE REQUIREMENT THAT DEVELOPERS FINANCE HARD SERVICES HAVE COMBINED TO DEMAND HUGE INCREASES IN THE FINANCIAL RESOURCES NEEDED BY DEVELOPERS, MAKING LAND DEVELOPMENT INCREASINGLY EXPENSIVE.

AT THE SAME TIME, A COMBINATION OF SLOWER ECONOMIC AND POPULATION GROWTH ON THE ONE HAND AND OF INCREASING PLANNING REGULATION AND CITIZEN PARTICIPATION ON THE OTHER, WILL LIKELY TEND TO MAKE LAND DEVELOPMENT INCREASINGLY RISKY.

BOTH THE INCREASING EXPENSE AND THE INCREASING RISK TEND TO FAVOUR THE LARGE, INTEGRATED COMPANIES OVER SMALLER COMPANIES. THUS, WHILE THERE IS NO EVIDENCE THAT MONOPOLY POWER IS A PROBLEM NOW, IT COULD BECOME A SIGNIFICANT PROBLEM IN THE FUTURE IF THESE POLICIES AND TRENDS ARE NOT REVERSED. }

Figure 5.B Decision Tree For Assessing Industry Structure



DECISION TREE FOR ASSESSING INDUSTRY STRUCTURE

6. Conclusions

6.1 The Short-Run Boom, 1972-1975 - Asset Revalu- ation Was The Real Cause, Not Monopolistic Developers Or Government Red-Tape

Two popular "conspiracy" theories are prevalent to explain the rapid price increases of the boom years 1972-1975.

One is the "Monopoly-Developer" theory. It holds that developers could withhold lots, fix prices, rig markets, subvert governments and probably devalue our currency.

The other is the "Government Red-Tape" theory. It cherishes equivalent fantasies about the lust for power of the "new class" - the zealous bureaucrats who strangled the production of new lots.

We have concluded that these and other supply-restriction theories are not adequate to explain the extreme price increases of the boom. Rather, the boom was a phenomenon of asset revaluation caused primarily by increases in demand rather than by restrictions in supply.

The plodding forces of demand and supply which over long periods determine house and land prices gave way to more aggressive and immediate forces which for a short while dominated the market. Rapidly rising incomes, rapidly increasing family formations, inflationary expectations, liberal mortgage financing, falling investment opportunities on the stock market, exemption of houses from capital gains tax, all contributed to this revaluation. Within only a couple of years, the relative desirability of land and houses as assets increased dramatically. Owners wanting to sell demanded more. Buyers were prepared to pay more - so much so that often they offered more than the asking price. East of the Ottawa Valley, slower population growth and lower expectations tempered the rising prices. But although the intensity of the price rise varied from region to region, the phenomenal change in attitude that underlay the price boom was nation-wide.

Great Expectations

Simply, houses and land were revalued relative to other assets in the market. Expectations of even higher future prices fueled a speculative overlay, while the depressed rates of return on other assets cranked up the demand for land and houses. Demand factors, some of which had been working away for a number of years, underwrote the widespread expectation that housing prices were going even higher, while world-wide inflation reduced the attractiveness of alternative forms of investment.

Thus, a "mere" change in expectations dramatically increased the demand for housing.

6. Conclusions

However, only the lengthy process of actually producing lots and houses can increase supply. It is true that governments control or influence many of the factors which can over the long run significantly increase or decrease supply. But in the short period of rapidly increasing expectations governments could not have prevented the extreme price increases even if they had worked overnight miracles and converted planners to producers, stopped some municipalities from "selling" subdivision approvals, forced municipal engineers to abandon their excessive and/or obsolete servicing standards, made citizen groups into tabbycats and adequately compensated municipalities for the tax deficiencies of affordable housing.

Nevertheless, if governments did make these kinds of changes, for any given level of demand, long-run price levels would either decrease or increase less rapidly than if such changes were not made.

6.2 The Law Of Supply And Demand: Not Yet Repealed

The British North America Act At Work

The demand for land can increase overnight, and did; to supply this land can take years. This profound difference is important because different levels of government are legally responsible for different components of the land price equation.

To the extent *demand* is influenced by government, the federal government is the major catalyst.

Supply, however, is largely controlled or influenced by the provinces and municipalities. The provinces have the ultimate responsibility for land use planning, protection of the environment and the financial health of municipalities.

Municipalities have responsibility for planning and services, and must cope with the insistent demands of activist ratepayers.

This pattern is neither an accident nor a conspiracy. It is only the British North America Act at work. Within its areas of responsibility Ottawa has tended to proclaim policies which heat up demand and which therefore require the supply actors, the provinces, the municipalities and the developers, to respond. Instant response is simply not possible - it is far beyond their institutional capacities, their financial strengths and their political mandates.

These statements are not an argument against federal government intervention on the demand side. Hundreds of thousands of Canadians have benefited from exemption from capital gains tax, low ratio mortgages, subsidized interest rates and the like.

6. Conclusions

But the statements are an argument for Ottawa to consult with the supply actors before it intensifies any demand factors. Such prior consultation is essential to permit them the time to expand supply with the minimum of price fluctuations.

6.3 Long-Run Prices: Government Is The Key

The influence of government cannot be overstated.

Land use is one of the few areas of policy regulated by all governments. Rarely are fewer than three levels involved; many areas have a fourth, regional level; and sometimes a fifth level, the neighbourhood, is given "political" and legal status.

Of course, land near or inside growing urban areas will always be valuable simply because well-located land is scarce. Yet governments control or influence many other factors which can over years significantly increase or decrease the supply and thus the price of serviced residential land.

Much of this Report necessarily focuses on the prime influence of municipalities in planning and servicing. But it would be unbalanced were we to omit the strong influence of senior governments on land markets.

Ottawa for its part offers financial inducements to municipalities to permit lower-cost housing and subsidies to lower-income families to acquire housing. It exempts owner-occupied homes from the capital gains tax and makes high-ratio mortgages possible. And in 1973 it sharply increased the funds available for provincial land banks.

Various provinces took advantage of Ottawa's funding to acquire large land banks, reorganized municipalities just before or during the boom, protect water quality and the natural environment by prohibiting or limiting certain kinds of development in certain areas, decide on major trunk services, offer subsidies to lower-income families to acquire housing and limit municipal taxes to the property base.

Finding 30 MANY FEDERAL POLICIES MAXIMIZE DEMAND.

BUT ON THE SUPPLY SIDE, MANY GOVERNMENT FORCES WORK FOR RESTRICTIONS.

MANY PROVINCIAL POLICIES MAXIMIZE PROTECTION OF THE ENVIRONMENT.

MANY PROVINCIAL AND MUNICIPAL PLANNERS MAXIMIZE ORDER.

6. Conclusions

MANY MUNICIPAL COUNCILS MAXIMIZE THE WELFARE OF THEIR EXISTING RESIDENTS.

MANY MUNICIPAL ENGINEERS MAXIMIZE SERVICING STANDARDS.

FEW IN GOVERNMENT SEEK TO MAXIMIZE PRODUCTION RELATIVE TO NEED.

OF COURSE, MANY SUCH GOVERNMENT DECISIONS THAT RAISE PRICES ALSO IMPROVE THE URBAN ENVIRONMENT, OR SERVE OTHER IMPORTANT PURPOSES NOT RELATED TO LAND OR HOUSE PRICES. NEVERTHELESS, THE CUMULATIVE IF OFTEN UNINTENDED RESULT OF PUBLIC POLICIES HAS BEEN TO INCREASE HOUSE PRICE LEVELS OVER THE LONG RUN BY INCREASING SUPPLY RESTRICTIONS ON THE ONE HAND AND DEMAND ON THE OTHER.

WHAT IS MISSING FROM THE EQUATION IS BALANCE. PRODUCTION RELATIVE TO NEED MUST BE BALANCED AGAINST OTHER LEGITIMATE SOCIAL CONCERNS. THE SOLUTIONS TO THOSE OTHER CONCERNS ARE NOT ABSOLUTE IMPERATIVES BUT RATHER BENEFITS WHICH CAN BE PURCHASED ONLY AT A RELATIVE COST IN TERMS OF ANOTHER THING OF VALUE, CHEAPER LAND AND HOUSING PRICES.

Good Intentions
And
Perverse Results

GOVERNMENTS OUGHT NEVER TO UNDERESTIMATE THE POWER OF OUR COMPLICATED SYSTEMS TO PERVERT THEIR GOOD INTENTIONS INTO UNINTENDED RESULTS.

6.4 Not The Last Word

We were constantly urged to lay many controversial issues to rest once and for all. We can make no such claims of achievement. Nothing can be gained by pretending a certainty which does not and cannot exist. Our critical review process was an attempt to minimize error, reduce omissions and consider all sides.⁽¹⁾ But on a subject so complex, so controversial, so steeped in ideology and in some areas so unmeasurable, incomplete judgment is inevitable and omission unavoidable.

We therefore conclude by expressing our deference to the unknown. No one can suppose that a broad work of synthesis will remove doubt or eliminate controversy. But we believe that we have replaced some fallacies with facts and some myths with meaningful analysis.

(1) See Appendix 1.

7. Our Findings Collected In One Place

2. THE REAL ESTATE BOOM OF 1972-1975

2.2 Popular "Conspiracy" Theories

- Finding 1** The land and house price explosion of the boom of 1972-1975 was not caused by:
- . provincial and municipal "red tape";
 - . high municipal lot levies, "goldplated" municipal services or municipalities protecting their property tax base;
 - . citizen resistance to new development; or
 - . government taxation policies.

But each of these factors has contributed and will contribute to high price levels.

- Finding 2** The land and house price explosion was not caused by either high profits or monopolistic developers.

2.3 Looking For Answers

- Finding 3** When production levels were unprecedented, huge price increases cannot be explained by alleged cutbacks in production.

- Finding 4** During the boom, lot prices in some places in some years rose 30% to 40%. Neither developers nor municipalities, neither ratepayers nor planners, could sufficiently strangle supply for the short years of the boom to explain either price rises of that magnitude or their occurrence across much of the country. The reason is that they can restrict only *new* housing, not *existing* housing, Yet in most growing urban areas about 95% of the housing stock is fixed in the short run while the annual production of new housing units is only about 5% of the existing stock. Because the existing stock dominates the market in the short run, new housing production does not substantially affect the total housing market over short periods of time. The 5% tail cannot wag the 95% dog in the short run.

In The Short Run,
The 5% Tail Cannot
Wag The 95% Dog

This is not to suggest that if they exist, "monopolistic" developers and "selfish" municipalities, government "bureaucrats" and "paranoid" ratepayers, ought not to cause concern. However, their production restrictions, if any, would gradually cause higher long-run price levels, not the *rapid increases of the boom*.

2.5 Asset Revaluation - The Real Reason Behind The Boom

- Finding 5** The real reason for the boom was asset revaluation, not monopolistic developers or government red-tape.

7. Our Findings Collected In One Place

Great Expectations

In the early 1970's the new demand factors came together at the same time and impacted cumulatively. Prices rose. These initial increases combined with accelerating inflation to change our expectations about future land and housing prices. Since present prices are partly determined by future expectations, present prices were revalued sharply upwards. All of our evidence points overwhelmingly to demand factors and changing expectations as the primary forces behind the 1972-1975 land and housing price boom.

The Real "Conspiracy"

And whether some developers or municipalities, some ratepayers or planners, restricted the production of some lots on the urban fringe, was clearly overwhelmed by this far broader short-run change. No feasible amount of new supply on the fringes of our urban areas could have prevented the extreme increases in existing house prices, for no feasible supply system devised by either man or miracle could have satisfied our great expectations. Compared to this overwhelming conspiracy of circumstances on the demand side, the popular supply-side "conspiracy" theories are feeble indeed.

3. AFTER THE BOOM

Finding 6

It is true that compared to the demand factors of the boom, supply factors usually change slowly. They nevertheless do change. Planners become more restrictive, municipalities become more sensitive to tax losses, servicing standards become more obsolete and/or excessive and ratepayers become more aggressive. And it is the *changes* in the levels of activity of planners, municipalities, engineers and ratepayers (relative to changes in demand) which increase land and house price levels slowly, but steadily.

The Long-Term Price Creep

These changes curtailing new production cannot create the increases of 40% per year we sometimes experienced in the boom. But when compounded over time these slow, gradual increases can become very significant indeed. For example, if an urban area's dwelling units were growing at 4% per year, the amount of housing would more than double in 20 years. However, if restrictions on supply reduced the growth of new housing to only 2% per year, the number of *new* houses after 20 years would increase by less than 50%. The effect of this restrictiveness could be to increase prices of *all* houses by as much as 30% to 40% or more over what they would have been had the 4% growth rate continued.

7. Our Findings Collected In One Place

4. LONG-RUN PRICE DETERMINANTS: PUBLIC SECTOR CONTROVERSIES

4.1 Planning, Approvals And Municipal Taxes

Finding 7 To acknowledge that government planning raises prices does not imply a criticism of planning. We do not accept the common charge of developers that the planning process is simply the purposeless pursuit of bureaucratic control. There are important reasons for government to regulate residential land, and the common criticism by developers that the approvals process is too long distracts us from the fundamental question: why have governments found it necessary to plan land development at all?

Planning: Private Costs Versus Public Costs And Environmental Mayhem

Governments plan land use because they know what will happen if they don't. They know from bitter and expensive experiences in past periods of high growth that unregulated private development can leave behind severe problems such as inadequately treated sewage and the need for expensive transportation systems which create hidden or delayed costs and environmental damage. If not compelled by the planning process, developers and their customers would neither pay these public costs nor avoid causing this damage.

Government regulation is indispensable to encourage patterns of development that minimize such costs and damage.

Finding 8 Earlier we dismissed the possibility that excessive planning restrictions could have been responsible for the rapid price increases of the short boom. But over longer periods, to lower the price of serviced lots permanently in the face of strong demand, it will be necessary for municipalities and planners *permanently* to increase the number of lots they permit to be produced. In other words, it is necessary that the process become less restrictive.

Planning Versus Production

Municipalities and planners ought to be responsible not merely for maintaining servicing and planning standards, but also for not inhibiting the production of quantity relative to need.

One can only hope, cautiously, that they will rise to the challenge of *balancing* adequate planning with adequate production.

Finding 9 Legitimate concerns over environmental issues, servicing standards, development patterns and densities have led to restrictions which underlay the lot supply shortage during the boom. They may in future lead to more restrictions, and we

7. Our Findings Collected In One Place

fear that the full impact on land prices of these increasing restrictions by provinces, municipalities and planners has yet to be fully realized.

Finding 10

Taxes Versus Homes

The basic problems of the municipal property tax remain - boundary fragmentation and biased structure. One inevitable cost/consequence is determined resistance to cheaper housing by many municipalities. To predict their continuing resistance is not to confuse the familiar with the necessary. Municipalities will continue to resist cheaper housing if their tax deficiencies continue uncorrected.

Who Are The Real Monopolists?

Their resistance is effective because monopolists do control many suburban land markets. However, the monopolists are not developers controlling output to protect their shareholders but municipalities restricting or highgrading growth to protect their taxpayers. Where only a few suburban municipalities cluster around a core area, each may exercise enough independent market power to restrict tax-deficient housing.

A Solution: Attack Municipal Deficits, Not Municipal Virtue

Senior governments are already moving towards a solution - partially compensating municipalities for losses on unprofitable housing. The funds, mostly federal, used to pay for the large provincial land banks which had no discernible impact on house prices during the boom, could have been spent more effectively this way. Since the basic problem is only one of revenues and not of principle, the solution is simply to attack municipal deficits, not municipal virtue.

Until the senior governments do what they can, the municipalities will do what they must.

Finding 11

Economic Reality Versus Legislative Wand-Waving

Governments can prevent development they don't want, but cannot by legislative wand-waving order into existence development they do want. Governments may establish broad development concepts and provide mainline sewage, storm, transportation and water facilities, but only economic reality decides the type and timing of development.

Even in Toronto's commercial core in 1976, only about 10% of all commercial properties had the maximum allowable floor area. Because of economic realities, private and public developers may not want to develop approved land immediately, or to seek approval in designated, "contiguous" areas, or to build those big houses which would be profitable to the municipality if only enough consumers could afford them.

7. Our Findings Collected In One Place

Shortages In The Midst Of Plenty

In spite of the best government intentions, the paradox of land shortages in the midst of plenty could become a reality because private and public developers will not necessarily develop in the places, at the times, for the uses and at the densities designated by governments.

4.2 Servicing, Lot Levies And Federal Taxes

Finding 12

Servicing Costs: Irrelevant To The Boom But Important For The Future

During the boom, lot prices dramatically outstripped servicing costs. Therefore servicing costs were not a major contributor to the boom. This finding is consistent with our earlier argument that factors affecting the production of new housing were not primarily responsible for the boom. Now that the price boom has ended, servicing costs will again become a major determinant of lot prices; our research has shown that hard servicing costs and not raw land costs are generally the major cost in producing serviced lots.

Finding 13

Servicing Cost Increases Can Be Controlled

Brampton adopted new value/effective techniques, with dramatic results. In 1976 Brampton's servicing costs in certain areas were up to \$4,600 per lot less than Scarborough's. Because Scarborough has imposed extremely expensive standards, savings of \$4,600 per lot may be higher than normal. But our judgment is that if municipalities across the country replaced their excessive and/or obsolete standards with the new value/effective techniques the total savings could be immense. Under the market conditions which in other sections of this Report we conclude are likely to prevail in the near future, some of these savings should be passed on to home buyers.

Finding 14

Whether To Compel When You Cannot Persuade

The difficulty is that servicing standards are a traditional municipal responsibility and provincial governments are extremely reluctant to compel changes they cannot achieve by persuasion. Perhaps on this issue the traditional reasons for not interfering, no matter how good, ought to give way to better. One solution which provincial governments could consider would be to impose on their municipalities value/effective standards as upper limits beyond which the municipalities could not demand anything further.

Finding 15

Because of compelling financial weakness, municipalities have delegated to developers the responsibility for local servicing. This delegation of responsibility has had an unintended effect. Since they no longer pay for local services municipalities have no incentive to adopt the most value/effective servicing techniques. The excessive and/or obsolete standards we observe in

7. Our Findings Collected In One Place

many municipalities are a predictable result.

Finding 16

During the boom, lot levies and non-deductibility, like servicing costs, likely had little impact on the supply or price of serviced land. Prices were demand-determined and developers were realizing very large profits. Developers probably absorbed these costs and reduced their windfall profits.

Pass It Back,
Pass It Forward,
Pass It Sideways

We cannot be certain about how these costs affect prices in the long run. Most likely they are passed around in a complex way: a portion is passed back to farmers in lower prices for raw land; a portion is passed forward to house buyers in higher prices for lots.

To the extent that lot levies may in some municipalities exceed actual municipal costs for the lots, some wealth may be passed sideways from developers, farmers and home buyers to existing residents as those municipalities cash in on their planning control by "selling" subdivision approvals.

4.3 Citizen Resistance To New Residential Development

Finding 17

Although citizen resistance to new development can cause extra costs and lost units, it was not a contributor to high lot and housing prices during the boom. Citizen resistance is a relatively new phenomenon and as we show elsewhere in this Report, prices were demand-determined during the recent past. We find, however, that from the end of the boom onward, citizen resistance could become an increasingly important determinant of lot prices in the absence of mechanisms to provide more effective representation for the interests of the potential housing consumer.

The Future Home Buyer:
Unheard And Unrepresented

4.4 Government Land Banking And Servicing

Finding 18

Critics of public land banking often charge that governments are bound to pay more for land than private developers because they are inherently inefficient and clumsy. Our evidence does not support this charge. Manitoba Housing and Renewal Corporation bought at market and Saskatchewan Housing Corporation in some cases bought below market. We therefore conclude that there is no inherent difficulty in governments attempting to buy land at market prices. However, some of Ontario Housing Corporation's experience demonstrates that governments run serious risks of artificially inflating prices when they attempt large assemblies at specific locations.

The Skill Of
Government Purchases

7. Our Findings Collected In One Place

Finding 19 We concluded in Finding 18 that governments are not inherently inefficient or clumsy. In land banking however they may be inherently late. The reason is that they face an inherent circular contradiction. Under the pressures caused by the boom, senior governments intensified their commitment to land banking in 1973, increasing funding on joint land banks that year from about 75 million dollars to about 185 million dollars, with Ottawa promising to spend half a billion dollars over the next several years. Governments cannot launch programs of this magnitude until the pressures have developed; but once the pressures exist, inevitably the programs are too late. There can be no doubt that the entry by strong, rich buyers into a market which was already overheated pushed up raw land prices.

**The Timing Of
Government Purchases
And Sales**

Successful land banking requires success in timing. The raw land should be bought when markets are soft and the finished lots sold when markets are rising. For the majority of assemblies studied performance in those respects during the boom was poor and could have neither smoothed out fluctuations nor depressed prices. Manitoba Housing and Renewal Corporation, Ontario Housing Corporation and Saskatchewan Housing Corporation all bought heavily during the boom. But MHRC did not supply any lots. OHC did supply lots from older assemblies, but supplied none from the several large assemblies in Ottawa, Milton and elsewhere acquired immediately before or during the boom.

Finding 20 Governments do sometimes take windfall profits. We find deficient, therefore, the argument that governments can supply lots more cheaply than private industry because they do not take windfall profits. This argument should not in future be permitted to influence government land policies.

Windfall Profits

Undoubtedly some governments have resisted the opportunity to take windfall profits. However, if governments do not take windfall profits when markets are good, who will subsidize windfall losses when markets are soft, as is now the case in many areas?

Finding 21 The data show that during the boom large-scale government assemblies had no moderating effect on house prices. Table 4.B illustrates their irrelevance by demonstrating that the house price increases in six urban areas with high government ownership were not significantly different than the house price increases in all 25 urban areas we studied. Therefore, a major purpose of these assemblies, reductions in overall price levels during the boom, was not achieved.

**Did Government Land
Banks Reduce House
Prices During The Boom?**

7. Our Findings Collected In One Place

5. LONG-RUN PRICE DETERMINANTS: PRIVATE SECTOR CONTROVERSIES

5.1 High Prices And High Profits, Which Caused Which?

Finding 22 Subdivision profits were very high during the early and mid 1970's.

Finding 12 Revisited The subdivision study lends strong support to our earlier finding on servicing costs that during the boom lot prices were not determined by the cost of supplying lots. This finding is also consistent with our earlier argument that factors affecting the production of new housing were not primarily responsible for the boom. The developers made so much money because prices went up so much faster than costs. High prices caused high profits; high profits did not cause high prices. John Kenneth Galbraith said it well: financial genius consists of short memories and rising markets.

High Prices Precede
High Profits

Finding 23 Few sellers anticipated the boom. Therefore land bought by developers during the 1950's and 1960's did not accurately reflect future values.

Finding 24 There is no evidence that profitability was related to the length of time the developer banked the land. Projects based on cheap land bought many years before development did not earn returns significantly different from returns earned by projects based on more expensive land bought only shortly before development. This does not mean that holding cheap land for a long time was not very profitable, merely that it was not necessarily more profitable than holding more expensive land for a short time. This appears to contradict the conventional wisdom.

Finding 25 The evidence does not support the theory that larger projects meant larger profits. Scale did not influence profits. Indeed, there may have been a small negative relationship between size and profit. This too appears to contradict the conventional wisdom.

Bigger Is Not
Necessarily Richer

Finding 26 High prices for raw land are caused by high levels of past profits and high expectations for future profits. The argument by developers that profits have to be high in order to enable them to afford high raw land prices is clearly backwards. The opposite is true. Raw land prices are high precisely because their past profits and expected future profits are high.

The Inventory
Replacement Controversy:
Developers Cry Poor

7. Our Findings Collected In One Place

Finding 27 A few notable exceptions apart, financial results of leading public land development companies for fiscal 1977 confirm an industry-wide trend to lower returns on assets. This current trend has become evident only during the later part of our work. In absolute terms, land development profits remain high today, but relative rates of return have peaked and are now declining. They are no longer disproportionate to the industry's heavy current investment in land.

The Past: Profitable
The Future: Unpredictable We therefore suggest to public policymakers that the very high profits of the recent past could be misleading as a guide to public policies for the future. Now that markets are no longer rising automatically, if at all, the inherent unpredictability of the development business will no longer be masked.

5.2 Is The Development Industry Concentrated Now?

Finding 28 In each direction that we have tried to test the monopoly-developer theory, our tests have been negative. We have found no evidence that monopoly power exists in either the land ownership or the land development industries. We would therefore be misguided to explain land prices as controlled prices.

5.3 Might The Development Industry Become More Concentrated In The Future?

Finding 29 Municipal lot levies, non-deductibility of current expenses and the requirement that developers finance hard services have combined to demand huge increases in the financial resources needed by developers, making land development increasingly expensive.

At the same time, a combination of slower economic and population growth on the one hand and of increasing planning regulation and citizen participation on the other, will likely tend to make land development increasingly risky.

Both the increasing expense and the increasing risk tend to favour the large, integrated companies over smaller companies. Thus, while there is no evidence that monopoly power is a problem now, it could become a significant problem in the future if these policies and trends are not reversed.

7. Our Findings Collected In One Place

6. CONCLUSIONS

6.3 Long-Run Prices: Government Is The Key

Finding 30 Many federal policies maximize demand.

But on the supply side, many government forces work for restrictions.

Many provincial policies maximize protection of the environment.

Many provincial and municipal planners maximize order.

Many municipal councils maximize the welfare of their existing residents.

Many municipal engineers maximize servicing standards.

Few in government seek to maximize production relative to need.

Of course, many such government decisions that raise prices also improve the urban environment, or serve other important purposes not related to land or housing prices. Nevertheless, the cumulative if often unintended result of public policies has been to increase house price levels over the long run by increasing supply restrictions on the one hand and demand on the other.

What is missing from the equation is balance. Production relative to need must be balanced against other legitimate social concerns. The solutions to those other concerns are not *absolute* imperatives but rather benefits which can be purchased only at a *relative* cost in terms of another thing of value, cheaper land and housing prices.

Good Intentions
And
Perverse Results Governments ought never to underestimate the power of our complicated systems to pervert their good intentions into unintended results.

The INDEX TO FINDINGS, page (i), will assist the reader to locate each Finding where it first appears in the body of the Report.

Appendix 1. Critical Review: How It Worked

Critical Review was a continuing process of checks and balances applied at every stage of the Task Force's work (see Figure A.1). It was structured not merely as casual debate but rather as an on-going process of rigorous refinement of methodologies, data, assumptions and conclusions. It had three purposes: (1) by subjecting all individual papers to sustained criticism from other experts in the same and also in other fields, to minimize error and reduce omissions; (2) by providing alternative viewpoints, to enable the Chairman to make independent decisions among the competing and often contradictory techniques, data, ideologies and assumptions; and (3) to provide a written record of the different points of view for the Chairman to consult while writing the Report.

Consequently, its mandate was to probe, test and judge. It was not unlike a judicial process, with the critical reviewers as prosecutors, each contributor or researcher as defendant and the Chairman as judge. Each contributor was required, as a pre-condition of employment, to agree in advance to this process of "cross-examination".

It took two forms. In face-to-face confrontations, some research papers were presented personally by the authors to large panels of fifteen to twenty critical reviewers who had received the papers in advance. The proceedings were taped and transcribed.

The other research papers were circulated for written critical reviews. Their authors were required to type them on a special form which provided ample space for reviewers' comments.

These transcripts or written comments were then returned to the authors of the papers for use in subsequent drafts and for vigilant monitoring by the Chairman or senior staff to ensure that all the relevant criticisms were in fact dealt with by the authors.

The process was indispensable. For example, one of our most basic findings, that asset revaluation and not supply restrictions was the main cause of the boom, gradually rose in importance during these debates until eventually it came to occupy a central position in the Report.

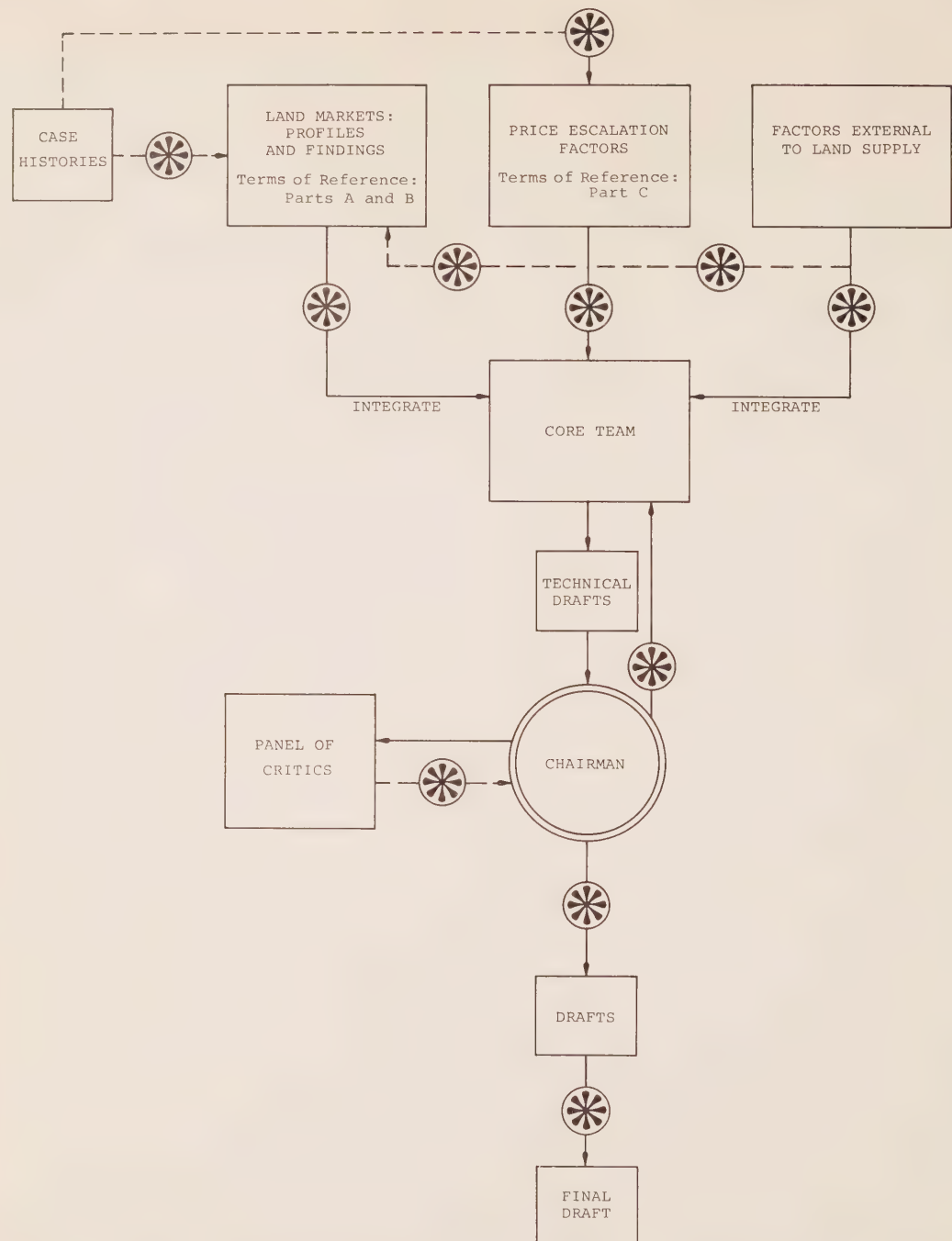
The process was also difficult. The extensive reviews consumed both time and treasure. They demanded considerable administrative coordination. They put an extra burden on all the contributors,

Appendix 1. Critical Review: How It Worked

but one that by and large was accepted graciously. There could be no room for prima donnas.

The Task Force spent much time in recruiting the critical reviewers from a wide variety of disciplines and occupations. They included economists, municipal politicians, senior federal, provincial and municipal policymakers, geographers, consulting engineers, land market analysts, land use planners, social policy analysts, financial analysts, developers and accountants. Their names are listed in the page of acknowledgments at the beginning of this Volume.

Figure A.1 Critical Review: The Adversarial Process



❁ CRITICAL REVIEW POINTS: An exchange of extensive written critiques and face-to-face debate between authors and critics conducted by the Chairman.

Appendix 2. Terms Of Reference

TERMS OF REFERENCE FOR

A FEDERAL/PROVINCIAL TASK FORCE ON

THE SUPPLY AND PRICE OF SERVICED RESIDENTIAL LAND

Subject Matter Of Task Force Examination

The task force will be charged with preparing a report in six to eight months after approval of the terms of reference. This report is to present findings and to draw conclusions, rather than to make recommendations. The report will be made public, in both official languages, immediately after its completion.

The task force will examine land markets in each province of Canada. Four types of land markets will be examined:

1. Those experiencing very high lot prices (for example, Toronto, Calgary, Edmonton, Ottawa, Vancouver);
2. those where ownership of land by private developers is concentrated (for example, Winnipeg, Ottawa, Calgary);
3. those which have a high degree of public ownership (for example, Regina, Charlottetown);
4. those where the cost of services is particularly high (for example, Halifax, St. John's).

These markets will be examined for:

- A. the proportion of the total price of housing formed by cost of serviced land;
- B. the component parts of serviced land prices:
 - (i) the cost of raw land to the developer;
 - (ii) the costs, including the impact of interest rates, of holding raw and serviced land until it is sold or leased;
 - (iii) the cost of constructing or installing services to the raw land;
 - (iv) the impost and development charges imposed by a municipality;
 - (v) the profits accruing to the developer;
 - (vi) the profits arising from infill rezoning.

Appendix 2. Terms Of Reference

C. The factors causing the level and escalation of serviced land prices:

- (i) the form, operation and time frame of the development approval process;
- (ii) effects of various standards of engineering, planning and density;
- (iii) the control of the supply of serviced lots available on the market by developers;
- (iv) the fiscal impact of residential development on municipalities;
- (v) citizen resistance to residential development;
- (vi) the effects of various forms of federal, provincial and municipal taxation;
- (vii) the effects of federal, provincial and municipal land programs of the respective housing agencies;
- (viii) the effects of the federal Anti-Inflation program;
- (ix) the adequacy of financing for land development;
- (x) the demand for land derived from demand for housing units.

Findings and conclusions will no doubt be more detailed for some factors and markets than for others.

Structure A. For the purposes of managing the work of the task force, the federal and provincial Ministers responsible for Housing will constitute themselves as a steering group with a working committee made up of Deputy Ministers. The working committee will have the following purposes:

- (i) to approve any changes proposed in the terms of reference as work progresses;
- (ii) to approve allocations of resources required;
- (iii) to approve the final report as meeting the terms of reference.

Appendix 2. Terms Of Reference

B. The task force shall be independent and shall consist of a Chairman and a Vice-Chairman, chosen by consensus of all Ministers, together with the staff and resources necessary for:

- (i) preparation of a more specific study design and work plan;
- (ii) co-ordination of the task force's work;
- (iii) preparation of the report.

Timing The following deadlines will apply:

1. Completion of Study Design and Work Plan: March 2, 1977.
2. Final Report: six to eight months after terms of reference agreed.

Costs It is proposed that the costs for the task force be borne half by the Federal Government and half by the Provinces. The budget for the task force leader, staff, premises and consultants, but excluding the costs of translation, production and printing, shall not exceed \$350,000.00.

March 2, 1977

